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Vol. II

TRANSCRIPT OF RECORD

Supreme Court of the United States

OCTOBER TERM, 1942

No. 11

GROUP OF INSTITUTIONAL INVESTORS AND MUTUAL SAVINGS BANK GROUP, PETITIONERS,

vs.

CHICAGO, MILWAUKEE, ST. PAUL & PACIFIC RAILROAD CO.

No. 12

GROUP OF INSTITUTIONAL INVESTORS AND MUTUAL SAVINGS BANK GROUP, PETITIONERS,

vs.

UNION TRUST CO. AND ILLINOIS STATE TRUST CO., AS TRUSTEES, ET AL.

No. 13

GROUP OF INSTITUTIONAL INVESTORS AND MUTUAL SAVINGS BANK GROUP, PETITIONERS,

vs.

ISRAEL A. ABRAMS, ET AL.

No. 14

GROUP OF INSTITUTIONAL INVESTORS AND MUTUAL SAVINGS BANK GROUP, PETITIONERS,

vs.

H. C. ORTON, ET AL., ETC.

No. 15

GROUP OF INSTITUTIONAL INVESTORS AND MUTUAL SAVINGS BANK GROUP, PETITIONERS,

vs.

GUARANTY TRUST CO. OF NEW YORK, ET AL., ETC.

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ON WRITS OF CERTIORARI TO THE UNITED STATES CIRCUIT COURT OF APPEALS FOR THE SEVENTH CIRCUIT

PETITIONS FOR CERTIORARI FILED {JANUARY 17, 1942. FEBRUARY 28, 1942.

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GROUP OF INSTITUTIONAL INVESTORS AND MUTUAL SAVINGS BANK GROUP, PETITIONERS,

vs.

CHICAGO, TERRE HAUTE & SOUTHEASTERN RY. CO., ET AL.

No. 17

GROUP OF INSTITUTIONAL INVESTORS AND MUTUAL SAVINGS BANK GROUP, PETITIONERS,

vs.

UNITED STATES TRUST CO. OF NEW YORK, AS TRUSTEE, ETC.

No. 18

GROUP OF INSTITUTIONAL INVESTORS AND MUTUAL SAVINGS BANK GROUP, PETITIONERS,

vs.

TRUSTEES OF PRINCETON UNIVERSITY, ET AL., ETC.

No. 19

GROUP OF INSTITUTIONAL INVESTORS AND MUTUAL SAVINGS BANK GROUP, PETITIONERS,

vs.

E. STANLEY GLINES, ET AL., ETC.

No. 32

RECONSTRUCTION FINANCE CORPORATION, PETITIONER,

vs.

CHICAGO, MILWAUKEE, ST. PAUL AND PACIFIC RAILROAD COMPANY, ET AL.

IN THE

Supreme Court of the United States

OCTOBER TERM, 1941.

No.

IN THE MATTER OF

CHICAGO, MILWAUKEE, ST. PAUL AND PACIFIC RAILROAD COMPANY,

Debtor.

GROUP OF INSTITUTIONAL INVESTORS, AND MUTUAL SAVINGS BANK GROUP,

Petitioners,

vs.

CHICAGO, MILWAUKEE, ST. PAUL AND PACIFIC RAILROAD COMPANY, ET AL.,

Respondents.

ON WRIT OF CERTIORARI TO THE UNITED STATES CIRCUIT COURT OF APPEALS FOR THE SEVENTH CIRCUIT.

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IN THE

United States Circuit Court of Appeals

For the Seventh Circuit

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7590—CHICAGO, MILWAUKEE, ST. PAUL & PACIFIC RAILROAD CO., Appellant v. GROUP OF INSTITUTIONAL INVESTORS, etc., et al., Appellees.

7610—UNION TRUST CO. and ILLINOIS STATE TRUST CO., as Trustees, et al., Appellants v. GROUP OF INSTITUTIONAL INVESTORS, etc., et al., Appellees.

7611—ISRAEL A. ABRAMS, et al., Appellants v. GROUP OF INSTITUTIONAL INVESTORS, etc., et al., Appellees.

7612—H. C. ORTON, et al., etc., Appellants v. GROUP OF INSTITUTIONAL INVESTORS, etc., et al., Appellees.

7613—GUARANTY TRUST CO. OF NEW YORK, et al., etc., Appellants v. GROUP OF INSTITUTIONAL INVESTORS, etc., et al., Appellees.

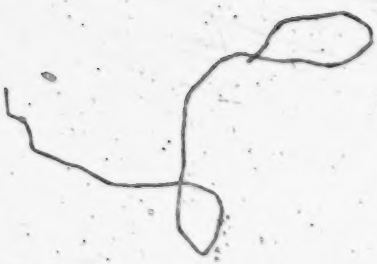
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3689 **ORDER.**

At a Session of the Interstate Commerce Commission, Division 4, held at its office in Washington, D. C., on the 15th day of June, A. D. 1937.

* * (Caption—10882) * *

It appearing, That the Bureau of Finance of the Commission has prepared a special report, dated June 5, 1937, on the railway operating revenues, other than freight, of the Chicago, Milwaukee, St. Paul and Pacific Railroad Company, debtor, and that pursuant to the provisions of section (77) (c) (11) of the Act of July 1, 1898, entitled "An Act to Establish a Uniform System of Bankruptcy Throughout the United States," the Commission may direct said Bureau to file such report in the proceeding pending before the Commission for the reorganization of said debtor, Finance Docket No. 10882;

It is ordered, That said report be filed in and made a part of the record in said proceeding.

By the Commission, Division 4.

W. P. Bartel,
Secretary.

(Seal)

5072 BEFORE THE INTERSTATE COMMERCE COMMISSION.

* * (Caption—10882) * *

Hearing Room,
I. C. C. Building,
Wednesday, June 16, 1937.
Washington, D. C.,

The above-entitled matter came on for hearing at ten o'clock, a. m., pursuant to adjournment.

Before:

Commissioner Claude R. Porter, Director O. E. Sweet, and Examiner M. S. Jameson.

Appearances:

Jack E. Bagon, 475 Fifth Avenue, New York, N. Y., appearing for Imperial Trust Company, Ltd.

J. T. Haslam, United States Treasury, Washington, D. C., appearing for Director General of Railroads.

C. Francis Murphy, Department of Justice, Washington, D. C., appearing for Director General of Railroads.

Joe D. Hughes, United States Treasury, Washington,
5073 D. C., appearing for Director General of Railroads.

Russell L. Snodgrass, Assistant General Counsel, 1825 H. Street, N. W., Washington, D. C., appearing for Reconstruction Finance Corporation.

Robert T. Swaine, 15 Broad Street, New York, N. Y., appearing for Chicago, Milwaukee, St. Paul & Pacific Railroad Company.

Thomas S. McPheeters, Jr., 314 N. Broadway, St. Louis, Missouri, appearing for St. Louis Union Trust Company and Illinois State Trust Company, Trustees of Chicago, Milwaukee & Gary Railway Mortgage Deed of Trust.

Edward E. Watts, Jr., 20 Exchange Place, New York, N. Y., appearing for City Bank Farmers Trust Company, as Trustee under the Milwaukee & Northern First Mortgage and as Trustee under the Milwaukee & Northern Consolidated Mortgage.

O. W. Dynes, 888 Union Station Building, appearing for the Trustees of Chicago, Milwaukee, St. Paul & Pacific Railroad Company.

D. Willard, Jr., 805 Transportation Building, Washington, D. C., appearing for the Railroad Credit Corporation.

5076 PROCEEDINGS.

Commissioner Porter: The hearing will be in order. The Director of Finance will make a statement.

Director Sweet: This proceeding has been assigned for further hearing at this time. The previous hearing held on August 5, 6 and 7, 1935, was adjourned without date.

At that hearing the evidence introduced was that on behalf of the Debtor in explanation of its plan for reorganization dated July 1, 1935.

Various parties were permitted to intervene at that hearing. The purpose of the further hearing was to permit the filing of certain information that was requested by the

Bureau of Finance since the last hearing and to bring the record of the Debtor's operations and financial condition down to date.

At this hearing it will be permissible also to file any additional plans and present additional evidence in support of or in opposition to the plan that has been heretofore filed.

Perhaps I should call attention, first, Mr. Commissioner, to the fact that today, by direction of Division 4, the Bureau of Finance is filing an additional statement regarding the revenues of the carrier and of the Trustees from traffic other than freight.

5077 Some time ago, by the direction of the Division, there was filed some exhibits and a statement regarding the freight traffic of the Milwaukee.

That is all I have.

Commissioner Porter: Have you any suggestions, Mr. Jameson?

Examiner Jameson: No.

Director Sweet: Anyone wishing to have a copy of the statement being filed today, regarding the revenues from traffic other than freight, copies are available here.

Mr. Swaine: I assume copies will be sent to all the parties of record?

Director Sweet: They will be, together with the order of the filing of those statements.

Mr. Freud: If Your Honor please, I have petition here filed by The National City Bank of New York and William W. Hoffman, as Trustee, under the adjustment mortgage of the Debtor, for leave to intervene in this proceeding.

They are already parties to the proceeding in the District Court of the United States for the Northern District of Illinois, and we wish to intervene here.

I have copies for the Commission and also additional copies for those interested.

5078 Commissioner Porter: Have the copies been distributed to counsel?

Mr. Freud: I will distribute them now.

Commissioner Porter: Any objections from anyone to the intervention just mentioned? There being no objection, the intervention will be allowed.

(The petition referred to was allowed and will be found filed in the Docket.)

Mr. Haslam: If Your Honor please, the Director General of Railroads has an interest in this proceeding and desires

to intervene. There has been a little delay by the attorney who is going to present the petition of intervention, and I think he will be here in a few moments. There will be copies for all parties.

Commissioner Porter: Well, then, I think we had better wait, probably, and consider that when he arrives.

Mr. Haslam: I thought it would be best to speak of it at this time.

Mr. Bagon: Your Honor, I would like to file a notice of appaarance and substitution of attorneys for the Imperial Trust Company, Ltd.

I am not admitted to practice before the I. C. C., but my application is on file.

My name is Jack E. Bagon, of 475 Fifth Avenue,
5079 New York City. I have here consent for substitution.

Commissioner Porter: It may be filed.

Anything else by anybody at this time preliminarily? It is my understanding that this is the first hearing that we have had in this matter now for something nearly two years. I was just wondering if the Debtor or anybody in its behalf had any additional suggestions to make at this time?

Mr. Swaine: Well, the Debtor is prepared to supply the information which was requested, and for that purpose I will call Mr. Scandrett.

Commissioner Porter: Very well.

H. A. SCANDRETT testified further as follows:

Direct Examination.

Q. (By Mr. Swaine.) I don't know what the last exhibit number of record was. The last exhibit that was actually filed was 109, but there have been several other documents sent in since that time, and, of course, the Commission, itself, has filed various documents in the proceeding, which I assume have been given exhibit nnmbers, so I don't know what the next number is.

Director Sweet: The next number is 118.

Mr. Swaine: At the previous hearing the annual reports
of the company through the year 1934 were admitted
5080 into evidence. I would now like to offer the 1935
annual reports, which, I take it, will be No. 118, and I also offer the 1936 annual report as Exhibit No. 119.

(EXHIBITS NOS. 118 and 119, Witness Scandrett, received in evidence.)

Q. (By Mr. Swaine.) Mr. Scandrett, will you be good enough to point out to the Commission the important matters covered by these two exhibits?

A. At the August 1935 hearing I summarized briefly the results of operations for the years 1928 to 1934, inclusive. I desire to make a similar summary of the years 1935 and 1936.

Railway operating revenues in 1935 were $92,473,793.29, an increase over 1934 of $4,614,001.24, or 5.3 per cent. Railway operating expenses were $76,416,517.08, an increase of $6,760,970.05, or 9.7 per cent. The increase was due principally to wage restorations, additional maintenance expenses and increase in traffic.

There was a decrease in general expenses from a credit adjustment of $746,043 of accruals charged for the year 1934 to cover the company's contribution under the Railroad Retirement Act, 1934, which was declared unconstitutional.

5081 Net railway operating income for the year 1935 was $4,723,982.78; income available for fixed charges which, effective with the accounts for 1935, included fixed interest on funded debt, rent for leased roads and equipment, interest on unfunded debt, and amortization of discount on funded debt, $6,035,713.87; fixed charges were $14,900,777.39, which left a deficit of $8,865,063.52 before deduction for interest on Convertible Adjustment Mortgage Bonds.

Interest on Convertible Adjustment Mortgage Bonds accrued at 5 per cent was $9,143,684.65, making the deficit for the year $18,008,748.17.

The net decrease in investment in road and equipment during the year 1935 was $883,327.95. This decrease was due to retirements and conversions of $6,434,366.73 less gross additions and betterments of $5,551,038.78.

Funded debt decreased $1,403,280.72, as follows: equipment trust certificates and principal of General American Tank Car Corporation and Austin-Western Road Machinery Company equipment leases paid during the year, $1,597,769.01, and $4,000 which in previous years had been deposited with the Trustee of mortgages for the payment of unpaid matured bonds of underlying division mortgages which had been released; total decreases, $1,601,769.01.

Increased during the year—Equipment Trust Cer-
5082 tificates, Series N, 4 per cent, $120,000; Austin-Western Road Machinery Company equipment lease, $78,488.29; total increases, $198,488.29.

During the year the Railroad Credit Corporation credited on our note dated June 27, 1934, $249,256.68, the Company's share of distributions under the Marshalling and Distributing Plan, 1931, leaving the amount unpaid as of December 31, 1935, $1,144,144.00.

The note of $1,710,000 dated May 29, 1933, was reduced to $1,585,000 by payments of $125,000. The balance of the advances to the Railroad Credit Corporation, subject to distribution in accordance with the Marshalling and Distributing plan, 1931, as of December 31, 1935, was $1,246,283.41.

In the year 1936 Railway Operating Revenues were $109,142,086.28, an increase over 1935 of $16,695,389.02, or 18.1 per cent.

Railway operating expenses were $85,244,354.34, an increase of $8,827,837, or 11.6 per cent. The increase in expenses was due principally to increase of traffic, unusually severe weather conditions in the early part of the year, increased wages, and from the result of a credit adjustment included in general expenses for the year 1935 to reverse contributions accrued in 1934 under the Rail-
5083 road Retirement Act, which was subsequently declared unconstitutional.

Railway tax accruals in 1936 were $8,135,000 as compared with $5,992,000 in 1935, an increase of $2,143,000. These accruals include $1,523,755 on account of the Railroad Retirement Act and $522,376 on account of the Social Security Act. The tax provisions of these acts were not in effect during 1935. Excluding these amounts, the balance of 1936 tax accruals was $6,088,869, an increase of $96,869 over 1935.

Net railway operating income was $9,461,358.38; income available for fixed charges $10,851,330.88; fixed charges, $14,903,754.45, which left a deficit of $4,052,423.57 before deduction for interest on convertible adjustment mortgage bonds. Interest on convertible adjustment mortgage bonds accrued at 5 per cent was $9,143,684.65, making the deficit for the year $13,196,108.22.

The net increase in investment in road and equipment during the year was $157,015.73. This increase was due to

gross additions and betterments of $8,433,521.30 less retirements and conversions of $8,276,505.57.

Funded debt in the hands of the public increased $1,548,816.75. It was increased $3,840,000 by equipment trust certificates, Series O, and reduced by the payment of principal of equipment obligations amounting to $2,291,5084 183.25.

Equipment trust certificates, Series O, principal amounts $3,840,000, were sold at par to the Reconstruction Finance Corporation. These certificates bear interest at the rate of 4 per cent and will mature serially beginning September 1, 1937, in ten equal annual installments of $384,000.

The proceeds from the sale of these certificates were applied to the cost of constructing in the shops at Milwaukee by the Trustees as builders, 37 passenger train cars for the "Hiawatha" and other trains and 1500 freight train cars, and to the purchase cost of a new "Hiawatha" locomotive. As of December 31, 1936, 37 passenger-train cars, 450 freight-train cars and the locomotive had been delivered to the railroad.

During the year 1936 the Railroad Credit Corporation credited on our note of June 27, 1934, $581,598.92, the company's share of distributions under the Marshalling and Distributing Plan, making the balance due on this note as of December 31, 1936, $562,545.48.

On the note dated May 29, 1933, payments were made during the year by the Milwaukee Land Company in the amount of $665,000, making the balance due as of December 31, 1936, $920,000. The amount due the Railroad Credit Corporation at the end of the year on these 5085 two notes was $1,482,545.48. The balance of advances by the company to the Railroad Credit Corporation, subject to distribution in accordance with the Marshalling and Distributing Plan, 1931, as of December 31, 1936, was $644,684.49.

Summarizing the foregoing for the period from January 1, 1935, to December 31, 1936, Railway Operating Revenues were $201,615,879.57; Railway Operating Expenses, $161,660,871.42; net railway operating income, $14,185,341.16; net income available for fixed charges was $16,887,044.75; fixed charges were $29,804,531.84; deficit of income before interest on Convertible Adjustment Mortgage Bonds, $12,917,487.09; interest on convertible adjustment mortgage

bonds, accrued at 5 per cent, was $18,287,369.30; making the deficit for the two years, $31,204.856.39.

During this period investment in road and equipment was increased by additions and betterments $13,984,560.08 and decreased by retirements and conversions $14,710,872.30, making a net decrease of $726,312.22.

Funded debt outstanding in the hands of the public increased $145,536.03. The Company's obligations to the Railroad Credit Corporation were reduced $1,620,855.60.

In the period July 1, 1935, to December 31, 1936,
5086 the Court authorized the payment of all principal and interest which, under the provisions of the Plan of Reorganization, had matured to December 31, 1936.

During this period principal of $2,411,412.54 and interest of $11,205,634.44 was authorized for payment, funds for which were provided out of the earnings of the trust estate.

Q. Now, Mr. Scandrett, at the last hearing there was introduced through Mr. Sparrow, as a witness, Exhibit No. 96 which set forth the operation of the July 1, 1935, plan, through a period of five years on the basis of certain earnings which were assumed for the purpose of that table.

It is my recollection that Mr. Sparrow stated that he refused to call it a forecast. He did say that he believed that the amounts taken as illustrative were amounts which could reasonably be hoped to be attained.

Since that hearing have you caused to be prepared a revision and a breaking-down to date of Exhibit No. 96?

A. Yes, sir; we have.

Q. Or rather, a bringing down to date of Exhibit No. 96?

A. We have compared Exhibit No. 96 with the actual results for that period.

Exhibit No. 96 introduced at the hearing be-
5087 fore this Commission in August 1935, estimated the results of operation under the proposed plan of reorganization, dated July 1, 1935, with gross revenues as shown and expenses estimated for such revenues for the last half of 1935 and for the years 1936 to 1940, inclusive.

A comparison of the assumed figures for the last half of 1935 and the year 1936 with the results of operation for this period shows that the actual railway operating revenues were $12,425,543 in excess of those shown in Exhibit No. 96; operating expenses were $4,008,334 higher; railway tax accruals, equipment rents, etc., were $1,877,472 higher; net railway operating income was $6,539,737 higher;

other income-net was $166,903 higher, and income available for fixed charges was $6,706,640 higher.

The fixed charges payable during the period were $244,306 lower, due for the most part to $240,000 interest included for 1936 in Exhibit No. 96 for a new loan from the Reconstruction Finance Corporation which was not made.

Exhibit No. 96 estimated for the period a deficit of $2,833,185 of available net income (under the proposed plan, that is, income after fixed charges; whereas the actual results for the period show available net income of $4,117,761, an increase of $6,950,946.

5088 The cash income for the period increased over that shown in Exhibit No. 96 in the amount of $7,642,605; disbursements increased $556,590, with a net gain in cash of $7,086,015.

Mr. Swaine: Now, at this point I would like to offer in evidence as Exhibit 120 a schedule setting forth the complete analysis of what Mr. Scandrett has just summarized, in the same form as Exhibit 96; in other words, it is an application to the actual figures for the last year and a half of the arguments that were set forth in Exhibit No. 96 and shows how the plan would have operated had it been in effect during this last year and a half.

(EXHIBIT NO. 120, Witness Scandrett, received in evidence.)

Q. (By Mr. Swaine.) Now, Mr. Scandrett, you stated in your summary that the amount charged as interest on new loans was lower than contemplated in Exhibit No. 96, because of the failure to take up certain proposed loans from the Reconstruction Finance Corporation. At the previous hearing you pointed out that those loans were for the purpose of making capital expenditures.

Does the failure to make the loans mean that you failed to make the contemplated capital expenditures?

A. No; it does not.

5089 Q. How were they provided?

A. They were provided out of earnings.

Q. Can you briefly summarize the principal capital expenditures that have been made during this period?

A. Expenditures for additions and improvements to road property and equipment were made under approximately 4000 AFE's. The larger projects with the amount charged to investment account are:

Engine terminal facilities at Bensenville in the Chicago district were enlarged and some changes made at Western

Avenue and Galewood at a total cost of $241,366. It is estimated this expenditure will result in an annual saving of $90,000.

Automatic block signals were installed through the Bitter Root Mountains between Haugen, Montana, and Avery, Idaho, a distance of 38 miles, at a cost of $127,790. With this improvement automatic block signals are now provided on all of the electrically operated lines.

A new fire alarm system was installed at Milwaukee Shops at a cost of $13,598.

Facilities for the manufacture of acetylene gas were installed at Dubuque, Iowa, at a cost of $12,984. Large quantities of gas are used at this point in connection with the dismantlement of cars and locomotives. It is esti-
5090 mated the installation will result in an annual saving of $6,000.

Two car department shop buildings at Milwaukee were rewired at a cost of $24,717. This work was necessary to eliminate the fire hazard.

Five stalls of the enginehouse at Minneapolis were reconstructed and enlarged at a cost of $27,679. This work was necessary in order to furnish adequate facilities for our large passenger engines.

A new wash and locker room for enginemen was constructed at Minneapolis at a cost of $8,751.

A new office building was constructed at Dubuque, Iowa, at a cost of $10,029.

The roof on the train shed at Minneapolis passenger station was replaced at a cost of $19,677.

Additions were made to the stock feeding yards at Aberdeen, South Dakota, at a cost of $15,045. This improvement was necessary in order that Montana stock can reach the Chicago market with but one feeding en route.

A new warehouse building was constructed at Butte, Montana, at a cost of $10,635. It is estimated this will result in an increase in net revenue of $31,500 per year.

Improvements to the passenger station facilities
5091 at Winona, Minnesota, were made at a cost of $11,-
118. These improvements were made necessary in order to facilitate the movement of our high speed passenger trains through Winona.

Fuel oil stations with electrically operated pump equipment were constructed at Chicago and Minneapolis for servicing the locomotives of the Hiawatha trains at a cost of $8,103.

Expenditures for new bridges, trestles and culverts amounted to $1,853,711. In addition to a large number of bridges and other water openings replaced with similar structures 14,384 lineal feet of open deck untreated timber bridges were replaced as follows:

With steel structures 1,569 lineal feet.

With creosoted timber and ballast deck trestles 3,884 lineal feet.

With culvert pipe 3,694 lineal feet.

With embankment 5,237 lineal feet.

In the two years 60,982 gross tons of new rail ranging in weight from 90-pound to 131-pound per yard and 42,732 gross tons of second-hand rail ranging in weight from 50-pound to 131-pound per yard were laid in main tracks replacing rail of the same or lighter weight.

In the same period 44 gross tons of new rail and
5092 18,293 gross tons of second-hand rail were laid in yard and side tracks displacing rail of equal or lighter weight. The total cost of the rail, together with angle bars, tie plates, rail anchors, switch material, etc. (including the charge-out price for second-hand material) was $4,882,080, of which $2,303,663 was charged to operating expenses and $2,578,417 to investment account.

Additional ballast chargeable to investment account was applied at a cost of $337,077. The greater part of this ballast was applied at points where main track rail was relaid.

Expenditures for shop machinery charged to investment account in the two years amounted to $376,008.

Two Hiawatha type locomotives and 21 30-cubic yard capacity dump cars were purchased in 1935 at a cost of $263,367. In 1936 authority was given for the purchase of one Hiawatha type locomotive and the construction of 37 passenger cars and 1,500 freight cars in our company shops. The locomotive and passenger cars and 450 of the freight cars were placed in service in 1936 and the balance of the freight cars in the first four months of this year. While the final cost has not been determined, it is now estimated at $4,600,000, a saving of $200,000 over the original estimate.

5093 Evans auto-loaders were installed in 348 automobile cars at a cost of $167,731.

Feed water heaters were applied to 22 locomotives at a cost of $71,028. It is estimated this installation will result

in an annual saving of $1,438 per locomotive or a total of $31,636.

Air conditioning was installed in 124 passenger cars at a cost of $760,552.

Those are some of the principal items. As I say, there were about 4000 AFE's issued in that period and authorized.

Q. Now, in addition to the table which has just been introduced showing the application of the 1935 plan to the actual results of 1935 and 1936, along the line of Exhibit 96, have you prepared a new statement along the same line covering the year 1937 to—or, rather, caused to be prepared, covering the years from 1937 to 1941, inclusive?

A. That has been prepared by our officers under my direction.

Mr. Swaine: I would like to offer that as Exhibit No. 121.

(EXHIBIT NO. 121, Witness Scandrett, received in evidence.)

(Q. (By Mr. Swaine.) Mr. Scandrett, will you be 5094 good enough to explain to the Commission just how that was prepared?

A. The impossibility of making a forecast of earnings for a period of years which one can say with definiteness will be approximately correct is, of course, recognized. With that reservation we have made a forecast of revenues for the next five years and, assuming those revenues, the probable results of operation down through cash as if the proposed plan of reorganization of July 1, 1935, had been put into effect at the beginning of 1937.

This is done by Exhibit 121.

This forecast is in form similar to that of Exhibit No. 96, presented at the previous hearing. The results in the present forecast are related to and differ from the results given in Exhibit No. 96 in particulars as I shall later, from time to time, note.

The upper part of Exhibit No. 121 shows our forecast of revenues, the expenses we estimate to go therewith and the resulting income available for fixed charges. Traffic rates, wage rates and material prices throughout are as of June 1937. In other words, we have not undertaken to forecast what, if any, changes will take place in these fields.

Of course, if using material prices as of June 1937,

5095 we are using prices which are very substantially higher than they were a year ago.

Freight revenue: For the year 1937, the first half is practically actual, and the last half is estimated at about 5 per cent above the last half of 1936. For other years the revenue of 1937 is trended upward at the rate of 5.8 per cent per year. This is practically the same trend as shown in Exhibit No. 96, but the general level is about $10,000,000 higher on account of the improvement made so far.

The actual trend of freight revenues from the middle of 1935 to the end of 1936, when projected beyond 1937, shows a trend on 1937 of 13 per cent per year, but the actual trend for the past five months has leveled off, the main factor being the short crop of 1936, coupled with interruptions in industrial activity because of strikes.

A recent C. & N. W. study shows a trend upward from 1936 to 1940 of 4.7 per cent per year. Our present forecast embodies the judgment of our freight traffic and other officers.

Passenger revenue: For the year 1937, the first half is practically actual, and the last half is estimated at 14 per cent above the last half of 1936. This is the increase so far this year over the corresponding period of last year.

5096 For subsequent years the revenue is trended upward at the rate of 10 percent per year—the 10 per cent being the judgment of our passenger traffic officers. Passenger revenues in Exhibit No. 96 were trended upward at the rate of 6.75 per cent per year. The recent C. & N. W. study uses a trend of 13 per cent year.

You will observe from that that the trend that we are using in the case of freight is somewhat in excess of that used by the North Western, and in the case of passenger, it is somewhat below the North Western trend.

All other revenues:

In 1936, all other revenues were substantially 10 per cent of the freight and passenger revenues, and in the forecast we have taken this percentage of the estimated freight and passenger revenues to represent all other revenues.

The forecasted total railway operating revenues are from $9,000,000 to $13,000,000 per year higher than those shown in Exhibit No. 96, and the forecasted results for 1941 are substantially the same as the revenues we had in 1930.

Operating expenses:

Maintenance of way and structures:

These expenses are, for 1937, our budget; for the
5097 other years, the estimate of our chief engineer of or
requirements. They are about $1,000,000 per year higher than those used in Exhibit No. 96, due mainly to the increased cost of material.

Maintenance of equipment:

The estimate for repairs is based upon a constant operating ratio of 14 per cent of revenues, although in 1937 it may be somewhat less. In Exhibit No. 96 we used 13.5 per cent and our experience since has justified that percentage.

The increase from 13.5 per cent to 14 per cent is because of increased cost of materials. Depreciation charges are computed at current rates, giving effect to tentative programs of new equipment and retirement of old equipment.

Transportation expenses:

For 1937, the first half of the year is based upon actual results; the last half year is based upon the last half of 1936 giving effect to the increased cost of fuel and the increased revenues.

For subsequent years we have used tables of freight and passenger operating ratios for varying amounts of revenues. These tables are the results of studies made from time to time with changing revenues, costs of labor and
materials, and changing operating conditions, and
5098 have been found to be fairly reliable for short distances into the future.

All other expenses (mainly traffic and general):

These are based upon a constant operating ratio of 6.1 per cent of revenues, derived from our experience of the past few years, allowing for increased costs to date.

Total railway operating expenses are from $5,000,000 to $10,000,000 per year higher than those shown in Exhibit No. 96 due largely to the greater volume of traffic expected.

It will be noted that we expect our operating ratio to be reduced from 78.1 per cent in 1937 to 73.6 per cent in 1941—a conservative estimate. I believe, in consideration of an increase in revenues from $112,800,000 to $141,000,000.

Income items:

Ordinary taxes: We are using our current accruals for 1937 and carrying these up in proportion with revenues for the future years. As we see it now, ordinary taxes were overestimated in Exhibit No. 96.

Other taxes:

Income tax and surtax on undistributed profits are computed on the income indicated by the forecast, less the allowable interest deductions. Railroad retirement
5099 and Social Security unemployment taxes are computed at the rates shown in the items upon the taxable payrolls estimated to be included in the forecast of expenses. No estimates for these taxes were included in Exhibit No. 96, there being no law on the subject at that time.

Total taxes as now forecasted will in 1940 be about $3,000,000 more than the taxes included in Exhibit No. 96 for that year.

Equipment rents, mainly payment for private car mileage, are now estimated but slightly higher than in Exhibit No. 96.

With new freight cars contemplated we expect to keep our debits and credits in per diem at least at a balance.

Joint facility rents have been fairly constant and we are estimating only a slight increase. The same is also true of other income.

Income available for fixed charges for 1937 is estimated at $12,000,000 which compares with $10,800,000 actual in 1936, and with $9,000,000 estimated in Exhibit No. 96 for 1937. For 1940 we are forecasting an income of $17,500,000 which is not far different from the estimate in Exhibit 96 for that year. The present forecast does not give more income than that estimated in Exhibit No. 96 for 1940 is largely due to the increase in taxes.

The middle part of this exhibit shows fixed charges,
5100 available income and disposition of available income
—under the proposed plan of the reorganization of July 1, 1935.

Fixed charges are those shown in the proposed plan of reorganization except that we have added interest on a reorganization loan of $8,000,000. The amount of this loan was developed by working the forecast down through cash without the loan which showed our cash on hand would be

about $8,000,000 less than it should be. The problem of making this loan will be discussed later.

The income remaining after fixed charges is the available net income of the plan—disposition of which is provided for in Section IV of the plan.

A question arises as to the conditions under which the contingency reserve fund of $3,000,000, as provided for in paragraph 2, Section IV of the plan, may be created, and as to just what uses may be made of such a fund. It apparently cannot be used for capital expenditures as a capital fund for such purposes is later provided. It is doubtful if it can be used to repay loans such as the reorganization loan provided in this forecast. Coming directly after fixed charges it would seem to be designed to protect payment of fixed charges in a succeeding accounting period.

5101 It can be used to carry over earnings of the last halves of years, when we make most of our annual earnings, to the first halves of the succeeding years, when our earnings are normally low. In any event, it would not be available to increase our working fund if the plan were put into effect in the first half of any year as it would not then be available and our forecast is as if reorganization were made effective the first of 1937.

We have not used this fund in the distribution of available net income in our forecast on the assumption it can only be used to equalize earnings as between accounting periods. If it can have a broader use it will act as an additional safeguard to the forecast.

Before the 1935 plan could be put into operation the permissible use of this fund should be more precisely described.

Our distribution of available net income goes first as provided in the plan to the payment of the contingent interest on general mortgage bonds, including in the first two years such interest accrued unpaid in the last half of 1935 and the year 1936.

In this forecast the current contingent interest is fully paid each year and the past accrued unpaid interest is paid in 1937 and 1938. This interest must all be paid in full before we can make any appropriation from

5102 income to the capital fund, and herein is the major reason we have to have a reorganization loan to put the plan in effect. It will be noted from line 56 in the cash

statement at the bottom of this exhibit that we annually require from $12,000,000 to $14,500,000 for capital expenditures including principal payments on equipment trusts, initial payments on new equipment trusts, etc., and from lines 45 and 46 that the available money for this purpose from depreciation and retirement charges in operating expenses and salvage from road property and equipment retired amounts to from $8,000,000 to $8,900,000 a year—requiring appropriations from income for this purpose of from $4,000,000 to $5,000,000 per year.

According to this forecast, while we would pay about $13,000,000 of contingent general mortgage interest and about $8,000,000 contingent interest on the Fifty Year and Gary Bonds we yet would require an $8,000,000 reorganization loan to put the plan into effect.

If the capital fund appropriation were put ahead of the contingent general mortgage interest we would only have to borrow about $3,000,000 to raise the level of our working capital—and that would be materially reduced if the Railroad Retirement Act taxes accrued in 1936 are released by the Amendment to the Act now before Congress. That would add to our cash about $1,700,000.

5103 The Contingent, general mortgage interest would under this change still be paid in full in the period but the money available for interest on the Fifty Year and Gary bonds would be reduced by about $5,000,000.

Our second distribution as provided in the plan is to the capital fund, the amounts being in 1937 and 1938 the remainder of the available income—nothing being available in 1937 and $2,596,178 in 1938. In these years we would deplete our cash to make up the requirements. In the subsequent years the amounts are those necessary to make up the difference between our requirements (line 56) and the funds available from depreciation and retirement charges in operating expenses and salvage from property retired (lines 45 and 46).

In the last year the difference would slightly overrun the maximum allowance of appropriation from income for this purpose under the plan and cash consequently would be slightly depleted.

Our third distribution as provided in the plan is to the latest maturing extended payments of equipment trusts.

The remainder of the available income is assigned to the contingent interest on the Fifty Year and Gary Bonds

—in the last year $4,224,763 being available for this purpose as compared to the full requirements of
5104 $5,469,755.

The bottom part of this exhibit shows cash income, the disbursements therefrom and cash on hand, giving effect to the proposed plan of reorganization of July 1, 1935.

The cash statement at the bottom of this exhibit hardly needs explanation:

We start with cash as indicated by the accounting income available for fixed charges, add the depreciation and retirement charges in operating expenses, which do not represent outlay, the value of salvage from property retired, which is not accounted for in income, and in 1937 the proceeds from the reorganization loan, the sum being the total cash income.

We then show the disbursements required from cash income for interest, rents for leased roads and capital expenditures, including initial and principal payments on equipment trusts and thence derive the remaining cash on hand from all operations each year. To this is added the cash on hand at the beginning of each year, the total being the cash on hand at the end of each year. This latter figure has been held to a minimum of $9,062,000, showing, as against cash on hand at the beginning of the period, that about $2,500,000 of the $8,000,000 reorganization
5105 loan has been retained to permanently increase the working capital.

Q. The letter of the Bureau of Finance of May 4th requested the Debtor to supply the general balance sheet as of April 30, 1937 as well as the income account. I offer that in evidence as Exhibit 122.

(EXHIBIT NO. 122, Witness Scandrett, received in evidence.)

Mr. Swaine: The letter of May 4th also asks for a statement of the Milwaukee's investments in affiliated companies, similar to Schedule 218 of the annual report, showing book values of securities and market values, if available; it also asks to furnish the income account of each company for the last five years and latest available balance sheet of each, which I offer in evidence as Exhibit 123.

(EXHIBIT NO. 123, Witness Scandrett, received in evidence.)

Mr. Swaine: There have been a series of four equipment obligations created since the last hearing. To com-

plete the record I would like to offer the agreement under which Series O were issued, which is the lease of railroad equipment, dated March 1, 1935, covering the road equipment trust Series O, as Exhibit 124.

(EXHIBIT NO. 124, Witness Scandrett, received in evidence.)

5106 Mr. Swaine: As Exhibit 125, I offer the supplemental lease; supplement to that lease and agreement.

(EXHIBIT NO. 125, Witness Scandrett, received in evidence.)

Mr. Swaine: As Exhibit No. 126, I offer the lease of railroad equipment, dated as of January 1, 1937, and the agreement furnished as of the same date, covering the railroad equipment trust series P.

(EXHIBIT NO. 126, Witness Scandrett, received in evidence.)

Mr. Swaine: I next offer as Exhibit No. 127, lease of railroad equipment, dated as of March 1, 1937, and the agreement dated as of the same date, covering railroad equipment trust series Q.

(EXHIBIT NO. 127, Witness Scandrett, received in evidence.)

Mr. Swaine: I next offer as Exhibit No. 128 an agreement made April 22, 1937, between Austin-Western Road Machinery Company and the Trustees of the Debtor, covering a series of equipment obligations.

(EXHIBIT NO. 128, Witness Scandrett, received in evidence.)

Mr. Swaine: The Bureau of Finance requested the Debtor to supply a list of all its equipment obligations in the form of Schedule 261-E of the annual report,

5107 showing the annual cost of equipment under each trust or list accrued depreciation charged upon each group, amount of each series of certificates outstanding as of June 30, 1937, and furnish tables showing for each equipment trust account the principal and interest accrued and unpaid as of June 30, 1937, the principal payments and interest payments due in each year from 1937 to 1947, inclusive.

First I would like to introduce as Exhibit 129, all the information required in the first sentence which I read, and then as to Exhibit 130, the information requested in the second sentence under that subdivision.

(EXHIBITS NOS. 129 and 130, Witness Scandrett, received in Evidence.)

Mr. Swaine: Now, the last sentence of that division of the Bureau of Finance letter reads as follows:

"Describe the future needs for equipment as far as known, and the program for retiring old equipment."

Mr. Scandrett, have you prepared a statement in answer to that question?

A. I have.

Q. Will you read it, please?

A. In the previous hearing an exhibit, No. 96, was
5108 submitted showing the possible results of operation of the proposed plan of reorganization for the last half of 1935 and the years 1936 to 1940, inclusive, under assumption of certain revenues. In the light of the conditions obtaining when this exhibit was prepared, it was thought that for this period we could probably get along with $15,000,000 of new equipment.

Since then revenues have increased at a greater rate than was contemplated in Exhibit No. 96 (they being 12 per cent over in 1936), and the prices for new equipment have materially increased. There has also developed an increasing demand for large cubical capacity cars and for high speed locomotives—both freight and passenger.

With the two additional engines of the Hiawatha type purchased since 1935, the total cost of equipment, freight and passenger locomotives and cars, purchased and authorized 1936 to 1937 (including the 1000 gondola general service cars and one passenger locomotive now being considered), will amount to approximately $15,096,000.

Locomotives:

Prior to 1930-1931 when we acquired 23 modern passenger locomotives we had not acquired any new steam passenger power for 18 years.

5109 Prior to this year, 1937, when we are acquiring 30 new heavy high speed freight locomotives, we had not acquired any new freight power since 1922-1923 (14 years) when we purchased 100 Mikado type locomotives.

Locomotives in use on our branch and secondary lines, while small and rather old, are still suitable for the service in which they are used and the replacement of these locomotives, notwithstanding their age, is still remote. Yard switching locomotives are obtained from road locomotives

released through the purchase of new road power but industrial switching locomotives, particularly in metropolitan areas, will probably be gradually and slowly replaced with Diesel locomotives which are more economical to operate and eliminate smoke and noise.

It is the opinion of our officers that in addition to the passenger locomotive now being considered for construction in our shops this fall, the following number of units and cost reflect our needs for the next five years:

30 freight locomotives, 15 passenger locomotives and 10 switch locomotives estimated to cost at current prices $7,250,000.

Passenger train cars:

During the 8 year period 1930-1937, including cars
5110 now being built we acquired 167 passenger train cars.

Because of uncertainty as to the extent of recovery of passenger traffic, it is particularly difficult to make an estimate of the future needs of this class of equipment. Some of our older passenger cars have been rehabilitated and air conditioned so that their life has been considerably lengthened, and when it becomes necessary to replace our company-owned sleeping cars this will probably be done by extending Pullman service. We now have Pullman service on most of our principal trains.

It is the opinion of our officers that the following number of units and cost reflect our needs for this class of equipment for the next five years:

125 cars estimated to cost at current prices $3,268,000.

Freight cars:

During the 8 year period 1930-1937, including cars now being built and the 1000 under consideration, we acquired 6,381 cars.

Future requirements will depend upon the amount of equipment retired and the increase in traffic. Anticipating some increase in traffic, it will be necessary to increase our ownership to some extent and it is the opinion of our
5111 officers that during the next five years we should acquire approximately 10,000 freight train cars estimated to cost at current prices $25,310,000.

With this number it is expected that the total ownership will be increased by holding retirements to something less than the acquisitions.

General:

Summarizing, it is believed that our total needs for the next five years are as follows:

55 Freight, passenger and Diesel switch locomotives	$ 7,250,000
125 Passenger train cars	3,268,000
10,000 freight train cars	25,310,000
Total	$35,828,000

It is also believed that we can meet principal payments on existing equipment trusts and initial and principal payments on necessary new equipment trusts out of our annual depreciation accruals plus proceeds from salvage realized in dismantling equipment retired.

Charge to operating expenses for equipment depreciation in 1936 amounted to $5,359,964 and proceeds from salvage recovered from equipment retirements amounted to about $500,000. The depreciation charges will increase with the acquisition of new equipment at current costs.

Program for retiring old equipment:

5112 Future retirements will be influenced by the acquisition of new equipment and the volume of traffic. With the acquisition of new equipment and a growth in traffic we will retire something less than the acquisitions as we will want to increase our ownership.

Under this situation we will keep most of the older locomotives released by new power in reserve for our fall peaks of freight and our summer peaks of passenger traffic.

Old steel passenger cars will be treated in a like manner but the remaining wooden passenger train cars (150) used in branch and secondary line service will be retired with further decline in branch line service or as soon as acquisition of new equipment makes this possible. Freight train cars will be retired only when it is definitely demonstrated that they cannot be kept in service except at unwarranted expense for repairs.

Mr. Swaine: The next paragraph of the Bureau's letter of May 4th requested a statement of all bonds outstanding, including Terre Haute Bonds, showing the amount of principal and interest accrued and unpaid as of June 30, 1937.

I offer as Exhibit No. 131 the statement prepared in answer to that question.

(EXHIBIT NO. 131, Witness Scandrett, received in
5113 evidence.)

Mr. Swaine: And, I would like to state for the record, as indicated by the exhibit, the amount matured and unpaid as of June 30, 1937, does not include matured coupons, the payment of which had previously been authorized by the Court.

The total amount involved in these authorized but uncollected coupons is $646,703.

Paragraph 4 of the letter of May 4th requests a statement of Railroad Credit Corporation and R. F. C. loans outstanding, showing the annual interest charges on each and the amounts of principal and interest accrued and unpaid as of June 30, 1937.

I offer as Exhibit 132 a statement answering that request.

(EXHIBIT NO. 132, Witness Scandrett, received in evidence.)

Mr. Swaine: I offer as Exhibits 133 and 134, the following:

Paragraph 5 requests an approximate estimate of the annual charges during the next five years, in connection with the Railroad Retirement and Social Security Acts, and the Revenue Act of 1936; also charges and credits of this nature from 1934 to date.

I offer as Exhibit No. 133 the statement with re-
5114 spect to taxes under the Federal Revenue Act of 1936
and as Exhibit 134 a statement with regard to the Railroad Retirement and Social Security Acts, furnishing the information requested.

(EXHIBITS NOS. 133 and 134, Witness Scandrett, received in evidence.)

Mr. Swaine: Now, paragraph 6 of the letter of May 4th, approximate estimate of the funds necessary for working capital, rehabilitation, equipment and other purposes; indicate the proposed method of financing:

Q. Mr. Scandrett, have you prepared a statement in accordance with that request?

A. I have.

Q. Will you please read it into the record?

A. Our property including equipment is in good shape and no special rehabilitation funds are required. The equipment is adequate for current traffic, and new equipment as needed can be financed through equipment trusts.

Exhibit No. 121 (Forecast) shows, under the assumption of earnings therein made, that to put the proposed plan of reorganization into effect, pay up the contingent interest on general mortgage bonds accrued unpaid in the last half of 1935 and the year 1936, and to have an adequate
5115 working capital at the beginning of each year we would have to borrow $8,000,000.

About $5,000,000 of this fund would be used for additions and betterments in 1937 and 1938 when earnings are lowest and when in order to reach an appropriation of income to a capital fund, as provided under the plan, it is necessary first to pay up the past accrued general mortgage interest.

About $3,000,000 of the fund would be used to raise the level of our working capital as of the beginnings of the years. While under the assumption of increasing revenues we would soon earn all of our requirements each year, we would normally as in the past make most of our earnings in the second halves of the years.

We should therefore have around $9,000,000 cash on hand at the beginning of each year to promptly meet interest and principal payments falling due in the first seven months of the year, so that our cash will not run too low in July.

For example, with contingent general mortgage bond interest becoming fixed in a few years, as provided in the plan, interest payments on these bonds are required in the first seven months of the year as follows:

January 1, $2,699,566; April 1, $276,572; July 1, $2,699,556.

We had as of the beginning of this year $6,611,200
5116 cash on hand after deducting $1,655,500 for interest and principal payments authorized but unclaimed, $523,000 for Social Security taxes accrued but unpaid and $1,579,300 for Railroad Retirement taxes accrued but unpaid as of December 31, 1936. This latter amount, if and when released by present proposed amendment of the Act, would increase our cash a like amount and would reduce the amount we would have to borrow to put the plan in effect.

The $8,000,000 Reorganization Loan shown in Exhibit No. 121 (The Forecast) is our best estimate at this time of the new money required to put the proposed plan of reorganization in effect and for the purposes enumerated in Item 6 of Director Sweet's letter of May 4th this year.

It is thought a loan for the amount necessary up to $8,000,000 might be obtained from the Reconstruction Finance Corporation although this has not been discussed with that corporation.

If this should be impossible or not thought to be advisable, the property should not be reorganized under the present plan until we have accumulated a fund of this amount from earnings—possibly several years hence in the earnings in Exhibit No. 121 materialize.

The amount required as a reorganization loan would
5117 be greatly reduced if the proposed plan of reorganization were modified to put the appropriation from available income to the capital fund ahead of the contingent interest on general mortgage bonds.

It would then be limited to the requirements for additional working capital—about $3,000,000. As already pointed out this would result in deferring the payment of $5,000,000 contingent interest on the Fifty Year Bonds of '75 and the Gary Bonds. These bondholders would probably insist upon some compensation for this additional sacrifice.

Director Sweet: This $8,000,000 reorganization loan referred to, Mr. Scandrett, is a new suggestion now, isn't it? You didn't make that before?

A. Well, before, our plan contemplated borrowing from the Reconstruction Finance Corporation $24,000,000; $12,000,000 on equipment trusts and $12,000,000 additional secured by first and refunding bonds.

Now, this proposed $8,000,000 loan,—taking our forecast and taking our requirements, it appears to us at this time, unless the plan is modified in the way I have suggested, that we will require $8,000,000 to swing it.

Director Sweet: Well, would that contemplate any other participation by the R. F. C.?

5118 A. No additional; no.

Mr. Swaine: Well, putting it in another way, Mr. Director, the 1935 plan contemplated taking $12,000,000 from the R. F. C. for equipment, and $12,000,000 in addition for what might be called a capital fund.

The forecast shows, and the forecast and experience to date shows that of the $12,000,000 for equipment, only approximately $3,500,000 had to be taken out, while of the $12,000,000 for capital advancement, the forecast now shows only $8,000,000 would be required, so this is not only not a new suggestion, but a revision of the old suggestion.

Director Sweet: That is exactly what I wanted to understand.

A. Well, it is in lieu. Of course, the $12,000,000 provided by the commitment which we discussed when we were here before—that commitment has long since expired. That was contingent on the reorganization being made effective December 31, 1935.

Mr. Swaine: The next request:

Present status of general claims, referring to Exhibits 72 and 115.

I offer as Exhibit 135 the statement in answer to that request.

(EXHIBIT NO. 135, Witness Scandrett, received in
5119 evidence.)

Mr. Swaine: In order to supplement that, I offer a statement showing the outstanding direct unsecured obligations and claims as of May 15, 1937.

(EXHIBIT NO. 136, Witness Scandrett, received in evidence.)

Mr. Swaine: Paragraph 8 of the May 4th letter requests a brief description of lines abandoned since the first hearing; lines which it has been decided to abandon, and lines under investigation for abandonment.

I offer as Exhibit 137 a statement in answer to that request.

(EXHIBIT NO. 137, Witness Scandrett, received in evidence.)

5120 Q. (By Mr. Swaine.) Mr. Scandrett have you anything to add in explanation of that statement; if so, will you please make the explanation.

A. In the hearing of August 1935 there was filed by Director Sweet as Exhibit 98 a list of lines of light density which were designated as "Lines of Doubtful Earning Power".

After the hearing adjourned we furnished copies of formal studies that had been made covering 17 lines, 13 of which were listed in Exhibit 98. These studies were embodied in Exhibit 112.

There has now been prepared an exhibit which summarizes the results of the examinations of the other lines in Exhibit 98.

This exhibit was prepared late in 1935 in anticipation of an early resumption of the adjourned hearing, and covered the operations during 1934, the last calendar year for which

information was then available. It was not brought down to date because of the amount of work involved and also because improved conditions since 1934 made the income shown on this exhibit very conservative.

Mr. Swaine: This Exhibit that is now referred to, I offer as Exhibit No. 138.

5121 (EXHIBIT NO. 138, Witness Scandrett, was received in evidence.)

The Witness: This exhibit shows, first, the earnings local to the line, columns (d) to (o) inclusive, determined by crediting the line with 25 per cent of the system revenues from business originated or terminated at stations on the line, plus an allowance for system bridge traffic handled, if any, and charging the expenses which would be saved if the line were abandoned;

Second, the earnings on other system lines from business originated or terminated on the line under consideration, columns (p), (q) and (r):

Third, the net income to the system, column (s).

No proportion of system overhead expenses, such as the cost of owning equipment, general expenses, solicitation of traffic, superintendence, dispatching trains, etc., is included, since the abandonment of a short segment of line would not affect these expenses.

It will be noted that even in 1934, a very subnormal year, but three of the lines appear so weak as to warrant further study to determine whether or not they should be abandoned.

The first is the line Faribault to Zumbro Falls, Minnesota, which is the remaining part of a line that extended from Faribault to Wabasha, the east end of which

5122 was abandoned in 1934.

By the way, I noticed in looking over the record at the last hearing, they spoke of that as Jumbo Falls.

This portion was retained because it was believed that it would be profitable.

In 1936 a new study was made and upon request of local officers, who obtained promises of increased support in meetings held in the local communities, the line was kept in operation pending further developments. This line will be reviewed again later in 1937.

The second is the line Bozeman to Menard, Montana, which serves a territory that in past years produced a large amount of grain, and other agricultural products.

It is anticipated that with normal crops and a general pick-up in business it will again be profitable. Maintenance expenses are kept to a minimum and when rehabilitation is necessary, if traffic has not increased sufficiently, the line will probably be abandoned.

The third is the line Bonner Junction to Sunset, Montana, which is a logging railroad serving timber lands of the Anaconda Copper Mining Company.

The timber adjacent to the original line having been exhausted, the line was extended in 1934 from Sunset
5123 to Cottonwood Creek, a distance of 14 miles, to reach additional timber. As this extension was not put into operation until October 1934, the statement does not reflect a full year's operation.

In 1936 the revenues were approximately $107,000 an increase of about 150 per cent over 1934. The expenses did not increase proportionately, consequently the line was very profitable.

At the present time we have pending before the Interstate Commerce Commission applications for abandonment of portions of three of the lines that are listed in this exhibit. These abandonments are in connection with coordinations in which service is not to be abandoned as stations are to be served by lines used jointly with other railroads.

These are portions of the lines from Lewistown to Great Falls, and Great Falls to Agawam, Item No. 33 on Exhibit 98, and the line from Cedar Falls to Everett, Item No. 41, on Exhibit 98.

The estimated savings accruing to the Milwaukee in connection with these coordinations are about $33,000.00 per year.

Q. Question 9 of the May 4th letter requests recent further analysis, if any are available, showing the earnings of the Milwaukee and Northern, Gary, Terre
5124 Haute, and Milwaukee Lines west of the Missouri River as if independently operated.

For reasons which Mr. Scandrett will presently explain, the Debtor is unable to furnish that information in the form requested, because no accounts are kept on the basis of separate operation, and separate operation involves so many hypotheses that are wholly problematical that it is quite impossible to supply precisely that request; but, we have prepared information which I take it will serve the purpose of the Director, that is, the allocation of the actual

earnings of the property, as they are presently operated, assuming their continued operation as a part of the St. Paul System;—the allocation of earnings to the various lines requested, and I offer as Exhibit No. 139 a statement showing the allocation of actual revenues, expenses and net income to the Terre Haute Lines for the year 1936, and as Exhibit No. 140 a copy of the Rules governing the preparation of the separate records to show the results of operation of the Terre Haute Lines.

These are the rules which the Accounting Officers observed in the preparation of Exhibit No. 139.

(EXHIBITS NUMBERS 139 and 140, Witness Scandrett, were received in evidence.)

5125 Q. (By Mr. Swaine.) Mr. Scandrett, will you make such explanation of Exhibit No. 139 and 140 that you think appropriate?

A. At the hearing before this Commission in August, 1935, there were introduced Exhibits Nos. 89 and 90 showing revenues, expenses and net income of the Terre Haute Lines for the years 1925, 1926, 1933 and 1934, at which time the methods used in arriving at the revenues, expenses and net income were explained.

While we were of the opinion that the methods used gave accurate results, it was decided, effective July 1, 1935, in order to avoid any question, to maintain an entirely separate accounting system for Terre Haute operations, which includes a general ledger and various subsidiary ledgers, all supported by a system of journal entries and reports.

These rules provide, as nearly as practicable, for an actual determination of revenues, expenses and net income. Where a railroad is taken over and operated by another railroad as a part of its system, and it is desired to determine the cost of operating the railroad so taken over, certain items of expense have to be apportioned.

I refer to superintendence, through train operations not confined entirely to the railroad under considera-
5126 tion, traffic and general expenses common to the system. The method for such apportionments is explained in the exhibit.

In addition, in this case, the cost of repairing freight train cars and equipment rents have not been determined and accounted for as is done between separate railroads.

In the case of freight train car repairs, because of the

prohibitive expense, it is not the general practice of railroads to maintain a record of repairs by individual cars as in the case of locomotives, and as we do not have the mileage made by Terre Haute-owned cars, the cost of repairing Terre Haute-owned freight cars is determined by applying to these cars the system average cost per car per month.

In the case of equipment rents, the Terre Haute is allowed the customary per diem charge of $1.00 per car for its cars while off its lines, and the same charge is made against it for all foreign cars on its line.

It would not be fair to make such a charge for all Milwaukee-owned cars while on the Terre Haute for the reason that, as the Terre Haute is operated as a part of the Milwaukee-owned equipment be held on Terre Haute Lines than the Terre Haute as a separate railroad
5127 would be willing to accept and pay for at the rate of $1.00 per day.

We, therefore, obtained from our General Superintendent of Transportation, as we did before we maintained these separate accounting records, the number of empty coal cars which, in his judgment, the Terre Haute Lines require for each loaded car of coal, and eliminated from the per diem charges all Milwaukee coal cars in excess of the total number so determined.

Exhibit No. 139, a statement for the year 1936 of revenues, expenses and net income available for fixed charges. This statement is designed to show the earning value of the Terre Haute to the Milwaukee system and includes a division of freight charges at tariff rates for the transportation of Milwaukee coal over the Terre Haute on the basis of the coal being billed to selected points which give the Milwaukee the most favorable divisions of the through rates.

The exhibit shows that the net income available for fixed interest charges is $2,990,126, with a net income to the Milwaukee, after rental and other charges, of $1,825,266.

During this year there were 2,049,747 tons of company coal transported by the Terre Haute for the Milwaukee system other than the Terre Haute, foreign freight
5128 charges on which to the Milwaukee, if it had not had the Terre Haute lease, would have amounted to $2,106,406.

Question has been raised as to whether, in determining

the revenues, expenses and net income of the Terre Haute, it should be allowed the tariff rate, a part thereof, or nothing for the haul of Milwaukee company fuel.

The Interstate Commerce Commission, in its report on "Investigation of Chicago, Milwaukee & St. Paul Railway Company" (decided January 4, 1928), said:

"In their estimates the St. Paul officials credit Terre Haute revenues with full tariff rates on all fuel coal hauled for the St. Paul * * *. In the study made by our accountants the Terre Haute was credited with 5 mills per ton-mile for hauling company fuel. This is the rate at which the St. Paul for many years has computed freight revenue for transportation purposes."

The tariff rate of the Terre Haute for the haul of Milwaukee company coal averages about 6 mills per ton-mile. Using 5 mills instead of tariff rate the net income would be reduced by approximately $350,000 to approximately $1,475,000.

5129 In determining whether the Terre Haute Lines are profitable to the Milwaukee Railroad, it is immaterial whether full tariff rate, part tariff rate, or no tariff rate is allowed for the transportation of Milwaukee company coal by the Terre Haute.

Before the Milwaukee had the Terre Haute it had to pay tariff rates for the transportation of its company coal and, if it did not have the Terre Haute today, it would have to do so again.

The cost of hauling the company coal of the Milwaukee is in the expenses of the Terre Haute and, if no credit is given to it in its revenues for the haul of such coal, its net income is reduced, but the reduction is still a credit to the Milwaukee Railroad.

This is well stated by the following language taken from the report on the Terre Haute to the Court of Trustees Cummings and Haight:

"In considering the question of whether the Terre Haute was or was not profitable to the St. Paul, it is clear that if no allowance or only a partial allowance is made in the Terre Haute revenues for the haul of the St. Paul Company's locomotive fuel, the difference between the amount allowed to the tariff rate remains in the treasury of the St. Paul."

5130 If the revenue of $2,166,406, for the haul of company coal at tariff rates is deducted, the net income to the

Milwaukee of $1,825,266 would become a deficit of $281,140, and would represent the cost to the Milwaukee for the haul of the company coal, or 13.72 cents per ton, as compared with the tariff rate of $1.03 it would have had to pay had it not had the Terre Haute.

Mr. Swaine: I would next like to introduce as Exhibit No. 141, an allocation of Estimated Revenues, Expenses and Net Income of the Milwaukee and Northern Lines for the year 1936.

This is in further response to Paragraph 9 of the May 4th letter.

(EXHIBIT NO. 141, Witness Scandrett, was received in evidence.)

Mr. Swaine: I would also like to introduce as Exhibit No. 142, a memorandum showing the method used in making up that statement.

(EXHIBIT NO. 142, Witness Scandrett, was received in evidence.)

Q. (By Mr. Swaine.) Now, Mr. Scandrett, will you please make an explanation for the record of Exhibits Numbers 141 and 142.

A. Exhibit No. 81 presented in previous hearing, 5131 gave estimates of the revenues, expenses, and income of the Milwaukee and Northern Lines for the year ending September 30, 1933 and for the calendar year 1934.

The net income after interest on Milwaukee and Northern bonds outstanding for the year ending September 30, 1933 was a deficit of $95,269, and for the calendar year ending September 30, 1933 was a deficit of $95,269, and for the calendar year 1934 was a surplus of $46,511.

The method used in setting up these estimates is described in the record of this proceeding—beginning on Page 103.

A similar estimate of revenues, expenses and income for these lines for the year 1936 gives a net income after interest in Milwaukee & Northern bonds outstanding of $171,677.

The method used in setting up the estimate for 1936 is the same as that previously described in the record in connection with Exhibit No. 81—with the following exceptions:

In the previous estimates an interest rental was charged for all foreign and system railroad owned freight cars on or needed on the Milwaukee and Northern lines, computed

at 5 per cent on the estimated reproduction cost of the cars, less depreciation.

5132 In the present estimate, having obtained sufficient information as to foreign railroad owned cars on the lines, a rental is charged for the foreign railroad owned cars at the standard rate of $1.00 per day, and an interest rental at 5 per cent on the reproduction cost less depreciation, is charged only for the system cars.

This change in freight car rental necessitated a change in the method of allocating system freight car repairs and depreciation charges to the Milwaukee and Northern.

The System expenses for these items per car mile previously applied to the total car miles on the Milwaukee and Northern lines is applied in the present estimate only to the estimated system car mileage on these lines.

In previous estimates no rental was charged to the Milwaukee and Northern lines for system work equipment used on the lines, but proportions of the repairs and depreciation charges on this equipment were charged on the basis of work car miles.

In the present estimate a proportion of an interest rental at 5 per cent on the book value of system work equipment is assigned to the Milwaukee and Northern in the percentage that its expenses for Maintenance of Way and Struc-

5133 tures are to such expenses of the System.

For consistency and as an improvement in method, a proportion of system repairs and depreciation charges on work equipment is assigned in the present estimate to the Milwaukee & Northern in the percentage that its expenses for maintenance of way and structures are to such expense of the system.

In the previous estimate, passenger train car repairs and depreciation charges for the Milwaukee and Northern were obtained by applying to the total passenger train car mileage on the lines, the system expense per car mile for these items derived by dividing the system expenses by all passenger car miles on the system.

In the present estimate, this procedure has been refined by eliminating Pullman car miles in the car mileages involved.

In the previous estimate no charge was made to the Milwaukee & Northern for transportation on other system lines of the materials used or consumed on Milwaukee and Northern lines, nor was any credit given the Milwaukee and

Northern for the transportation on its lines of material used or consumed on other system lines.

In the present estimate, charges and credits are
5134 included for these items at estimated out-of-pocket costs of transportation.

The income statement in Exhibit No. 141 for Milwaukee and Northern lines in 1936 is a segregation of system revenues, expenses and income made in the manner described in Exhibit No. 142. It is not intended to be a reflection of the earnings of these lines under an assumption of independent operation by a separate company.

Mr. Swaine: I offer as Exhibit No. 143 a statement of Estimated Revenues, Expenses and Income of the Chicago, Milwaukee and Gary Lines and its contribution to the System for the year 1936.

This statement is slightly different; it is quite different in character of make up from those which have been introduced covering the Terre Haute and the Milwaukee and Northern, for reasons which Mr. Scandrett will explain shortly.

(EXHIBIT NO. 143, Witness Scandrett, was received in evidence.)

Mr. Swaine: I next would like to offer as Exhibit No. 144, the memorandum showing the detail of how statement No. 143 was worked out.

(EXHIBIT NO. 144, Witness Scandrett, was received in evidence.)

5135 Q. (By Mr. Swaine.) Mr. Scandrett, will you now make the explanation of that table?

A. Exhibit No. 85, presented in previous hearing, gave estimated of revenues, expenses, income and contributions of the Gary to System for the years 1928, 1929, 1933 and 1934.

The estimate for 1934 showed:

First, an income available for interest of $60,000 when allowing the Gary revenues at tariff rates on the bridge traffic, including company coal, sent over its line;

Second, a deficit available for interest of $84,000 when substituting for the bridge traffic revenues at tariff rates, the out-of-pocket cost of moving this bridge traffic over Milwaukee lines via Bensenville.

Third, a deficit of $32,813 when crediting the Gary with part of the Milwaukee's proportion of revenues from traffic originating or terminating on the Gary.

A description of the method used in making the estimate is given in the record, beginning on page 121.

With more time than was available for the previous estimates, we have made a more detailed study of reve-
5136 nues, expenses, income and contribution of the Gary for the year 1936. Almost all of the items of the revenues and expenses are actual ascertainments for the full year.

This Exhibit No. 143 is in the same general form as Exhibit No. 85.

It shows first, on the left hand side, block "A" an income available for interest of $54,161, when allowing the Gary revenues at tariff rates on the bridge traffic, including company coal, sent over the line;

Second, at the top of the right hand portion, block "B", a deficit available for interest of $45,816 when substituting for the bridge traffic revenues at tariff rates, the out-of-pocket cost of moving this bridge traffic over Milwaukee lines via Bensenville;

Third, at the bottom of the right hand side, block "D", an income available for interest of $48,933 when crediting the Gary with part of the Milwaukee's proportion of revenues from traffic originating or terminating on the Gary $94,749, as developed in block "C".

The only new item included in the estimate of 1936 as compared to the estimate of 1934, is a charge to the
5137 Gary for the haul of material used on its line or consumed in its operation.

This, in part "A" is at tariff rates, and in part "B" at estimated out-of-pocket haul costs. All other changes relate to better and more complete information.

None of the figures included in Exhibit No. 143, are intended to be a reflection of the income of the Gary if independently operated by a separate company.

Mr. Swaine: I offer as Exhibit No. 145, the information requested in Paragraph 9 of the May 4th, letter, with the modification which I made in connection with the other information furnished under that paragraph with respect to the Lines west of the Missouri River, and as Exhibit No. 146 a memorandum showing how Exhibit No. 145 was prepared.

(EXHIBITS NOS. 145 and 146, Witness Scandrett, were received in evidence.)

Mr. Swaine: In this connection it should be pointed out

that the lines west of the Missouri River which are referred to there are not the only lines subject to the First and Refunding Mortgage, and it was the understanding of the Officers and Counsel of the Debtor that what was desired to bring out here was the allocation of earnings on
5138 properties of the First and Refundings, as a first lien, and under the Fifty-year Mortgage and second lien.

We therefore, have included in this statement not merely the lines west as requested by the Director's letter but also those parts of the line east on which the First and Refunding Mortgage is a first lien, and on which the Fifty-year Mortgage is a second lien.

The Witness: The figures, are set up separately.

Q. (By Mr. Swaine.) Yes; that is right.

A. So that they can get either picture.

Q. Both are included in the statement.

It should also be borne in mind, which Mr. Scandrett will point out more in detail, that the First and Refunding Mortgage, in addition to covering this specific line, covers certain stocks and bonds.

As you will see from looking at Exhibit No. 145, it also sets out separately the income received from the stocks and bonds,—rather, the income paid upon the stocks and bonds which are pledged under the First and Refunding Mortgage; inasmuch as there are other stocks and bonds, the statement does not in any way reflect any income or loss suffered by the property on those stocks and bonds.

Similarly Mr. Scandrett will point out in detail the
5139 First and Refunding Mortgage is a lien upon the leasehold estate of the Terre Haute, but in that connection it should be pointed out that the Terre Haute joins the line of the St. Paul on the eastern end of its line, whereas the line upon which the First and Refunding Mortgage is the first lien, begins at the Missouri River; so there is a very wide gap between the lines for which the First and Refunding Mortgage is a direct first lien and the Terre Haute leasehold.

Mr. Scandrett, you have additional information as to those exhibits. Will you please read it into the record?

The Witness: Exhibits No. 92 and 93, presented in previous hearing, gave estimates of revenues, expenses and income available for interest for the properties subject to the first lien of the First and Refunding Mortgage, mainly

Lines West of Mobridge, for the years 1931 and 1930, respectively.

The estimate for 1931, Exhibit No. 92, showed income available for interest as follows:

For Lines West, a deficit of $1,540,808; for pieces of Lines East subject to the mortgage, income of $885,000; for securities pledged under the mortgage, income of $233,381;

and a total for all the properties subject to the mort-
5140 gage, a deficit of $422,427.

On the bottom of Exhibit No. 92 there was shown with respect to freight traffic moving between Lines West and East in 1931, the amount of the revenues accruing to Lines West, $9,402,807, and the amount accruing to Lines East, $5,839,764.

The method of making the estimates in Exhibits No. 92 and 93 is described in the record of this proceeding beginning on page 160.

Exhibit No. 145 is an estimate of revenues, expenses and income available for interest for these properties for the year 1936.

This estimate shows an income for this year as follows:

For Lines West, a deficit of $1,108,535; for pieces of Lines East subject to mortgage, income of $170,100; for securities pledged, income of $402,031, and a total for all the properties, a deficit of $536,404.

On the bottom there is shown with respect to freight traffic moving between Lines West and Lines East, the amount of the revenues accruing to Lines West $10,743,028, and the amount accruing to Lines East $6,249,099.

The method used in setting up the estimate for
5141 1936 differs from the method used in setting up the estimates for Exhibits Nos. 92 and 93 in the following particulars:

With respect to the estimate for Lines West:

In the previous estimate, Lines West were credited with transportation at tariff rates for their haul of material used on Lines East and debited at tariff rates for Lines East haul of materials used on Lines West.

In the 1936 estimate these credits and debits are continued but are based upon estimated out-of-pocket costs of haul on Lines West and Lines East. This change was made because with tariff rates the sources and movements might not be economical. The effect of this change is to reduce the net credit to Lines West $300,000.

With respect to the pieces of Lines East subject to the mortgage:

In the previous estimate no charges were made against the bridge or link pieces of lines for general terminal expense to offset the revenues assigned to these lines on the basis of system revenues per ton mile.

In the present estimate such a change has been made
5142 to these lines by applying to the revenues assigned, the system operating ratio of terminal division Chicago, Milwaukee and Twin City, expense including rental on switching locomotives used in these terminals. This increased the expenses by $364,000.

In the previous estimate no charges were made against any of these lines for the haul on other system lines of the materials and supplies used on these lines.

In the present estimates such charges are made against these lines on the basis of estimated out-of-pocket costs of haul. This increased the expenses $135,000.

With respect to securities pledged under the mortgage:

No change has been made in the previous method.

The income statement in Exhibit No. 145 for the properties subject to the First Lien of the First and Refunding Mortgage in 1936 is a segregation of System revenues, expenses and income made in the manner described in Exhibit No. 146.

It is not intended to be a reflection of the earnings of these lines under an assumption of independent operation by a separate company.

Exhibit No. 145 includes only lines upon which the First and Refunding Mortgage is a direct first lien and
5143 pledged stocks and bonds of issues on which dividends and interest are being currently paid.

In addition, as shown by Exhibit No. 73, the Terre Haute leasehold and various stocks and bonds on which dividends and interest are not being currently paid, are pledged under the First and Refunding Mortgage.

Mr. Swaine: Paragraph 10, of the May 4th letter requested a statement of the amount of freight surcharges collected during the years 1932 to 1936, inclusive.

I offer as Exhibit No. 147 a statement furnishing that information.

(EXHIBIT NO. 147, Witness Scandrett, was received in evidence.)

Mr. Swaine: Paragraph 11, requested a statement of

total reductions in payrolls each year 1932 to 1936, due to the 10 per cent pay cut. I offer as Exhibit No. 148 a statement covering that information.

(EXHIBIT NO. 148, Witness Scandrett, was received in evidence.)

Mr. Swaine: Paragraph 12 requested an analysis of freight revenues and tonnage for 1936 by commodities in the form of Schedule 541 of the Annual Report.

I offer as Exhibit No. 149, a statement furnishing 5144 that information.

(EXHIBIT NO. 149, Witness Scandrett, was received in evidence.)

Mr. Swaine: Now, in addition to that information, it was thought that it would be of interest to the Commission to have furnished to it a table showing variations in the amounts of some of the principal groups of commodities, carried during the years 1928 to 1936, showing variations not only in the actual revenues arising from those commodities, but the percentage of total revenues represented by those commodities, and such a table is now offered as Exhibit No. 150.

(EXHIBIT NO. 150, Witness Scandrett, was received in evidence.)

Q. (By Mr. Swaine.) Do you care to make any further explanation of that, Mr. Scandrett?

A. Well, I might comment briefly on this Exhibit No. 150.

It shows, by the different commodity groupings that are shown on the exhibit, for each of the years 1928 to 1936, the dollars of freight revenue and what that percentage was to the total revenue in that year; and, similarly, it shows the number of carloads and what that percentage was of the total carloads in that year.

5145 You will find by examining this Exhibit that there are very different results shown for different groups. Take, for instance, the first group, forest products, except pulp wood and logs, in 1928 the revenue was $16,360,000, and that dropped perceptably down to 1932 when it was only about 30 per cent of the revenue in 1928, now coming back substantially in 1936.

The revenues from those commodities was over twice what it was in 1932, although still not very much more than half of what it was in 1928.

You take another item, for instance, the second item,

coal and coke. There is no such variation. In 1928 the revenue was $13,642,000, and the lowest amount during the depression, which was in 1933, was $9,753,000. That is a substantial reduction, but nothing like the reduction in the lumber.

Grain, of course, varies very considerably from year to year, depending upon the crops, but the last six or seven years have been abnormally low years for grain.

On petroleum products you will find that notwithstanding there has been construction of a great many pipe lines for gasoline as well as for crude oil during this period, the revenues from that group in 1936 were
5146 actually slightly higher than they were in 1928.

Going to a commodity like ore, which is shown on the second page, you find that our revenue in 1932, the low point, was less than 10 per cent of what it was in 1929.

Traffic this year may come back somewhere near the 1929 figures. It started early and it has been moving in large volume, if strikes do not affect it too much.

Q. (By Mr Swaine.) Mr. Scandrett, the Director's letter of May 4th has reference to this statement, referring to today's hearing, that the Debtor or the Trustees will have oppotunity to file an amended plan, if they wished to do so.

Did you cause to be called a special meeting of the Board of Directors of the Debtor on May 14, 1937?

A. Yes.

Q. To consider that?

A. I called that meeting, and at that meeting there was quite a full discussion of the situation, and it resulted in the appointment of a committee of three.

Q. Who were they?

A. To investigate the subject and report to the Board.

5147 They were Messrs. Fairman Dick, Howland Davis and W. W. Colpitts.

Q. Did that Committee make a subsequent report to the Board?

A. They did, at a meeting on June 3rd.

Q. Will you be good enough to read into the record the report of the special committee and the action taken by the Board thereon?

A. Messrs. Fairman Dick, Howland Davis and W. W. Colpitts, the special committee appointed at the meeting

of the Board of Directors held May 14, 1937, made the following report:

All the members of the committee have, since the appointment of the committee, given special consideration to the question as to the position which the Company should take respecting the Plan of Reorganization dated July 1, 1935, at the hearing to be held by the Interstate Commerce Commission on June 16th.

In addition to their individual studies, the members of the committee have held two long meetings, at both of which counsel for the Board attended, and Mr. Dick, who has acted as chairman of the committee, had a further long conference with counsel to the Board with respect to the problems to be considered by the committee.

5148 Basically, the problem considered was whether the Company should:

(1) Urge upon the Commission the present approval of the 1935 Plan,

(2) Presently submit modifications of the 1935 Plan, or

(3) Request the Commission to postpone definitive action at this time and grant a further adjournment of the hearings upon the 1935 Plan.

It was recognized, at the time of the Company's adoption of the 1935 Plan, that, as stated in the Plan itself, the "soundness of the resulting capital structure will necessarily be determined by the earning capacity of the property in the future."

It was also recognized that there were two possible defects in the Plan, the seriousness of which could be determined only by future developments:

(1) The adequacy of the provisions for financing; and

(2) The cumulative interest feature of the modified 50-Year 5 Per Cent Mortgage Bonds.

As to the first of these points, the Plan contemplated provision for the near term financing requirements by loans from the Reconstruction Finance Corporation, for intermediate term financing requirements, during the early

5149 stages of the hoped for recovery of earning power, through the creation, out of net income, of a capital fund not exceeding $5,000,000 per year, before payment of the contingent interest on the 50-Year Bonds and for ultimate financing in the distant term upon a sufficient recovery in earning power to make the First and Refunding Bonds an adequate financing medium.

Of the $24,000,000 contemplated to be obtained from Reconstruction Finance Corporation, $12,000,000 for equipment and $12,000,000 for other purposes, the property has taken only $3,840,000 through the sale to R. F. C. of that amount of equipment obligations.

The balance of the property's requirements have been financed out of cash available through depreciation charges and other income, and through the sale of $5,835,000 of equipment obligations to private investors.

Meantime, the Reconstruction Finance Corporation commitment has lapsed by its own terms. The officers have not taken up with the Reconstruction Finance Corporation the matter of renewing the commitment because of the uncertainty of the Company's own position respecting the 1935 Plan, and doubt as to the desirability of now predicating reorganization on Reconstruction Finance Corporation financing.

5150 In this connection, the terms upon which the Reconstruction Finance Corporation financing was to be provided, particularly with respect to collateral, were not defined in the 1935 Plan, and in the light of various uncertainties hereinafter discussed requirements of collateral which might be entirely reasonable from the standpoint of the Reconstruction Finance Corporation might be prohibitive from the standpoint of the Company's security holders.

As to the second point, the 1935 Plan contemplated complete accumulation of contingent interest on the 50-Year Bonds with the right to premature those bonds on accrual of ten years interest because a majority of the Board of Directors felt, and representatives of bondholders consulted by the officers insisted, that any other treatment would require compensation for the sacrifice thus to be asked of the 50-Year Bonds, which would have resulted in much more drastic treatment of all securities junior to the 50-Year Bonds and perhaps the substantial elimination, as a practical matter, of the interests of the present stockholders.

Similar considerations prevented the inclusion in the 1935 Plan of the provision for future financing by a mortgage which would disturb in whole or in part the prior liens of the present General Mortgage Bonds and First
5151 and Refunding Mortgage Bonds.

A majority of the Board felt in June of 1935, although two members of the present committee then doubted,

that it was worthwhile to take the risks of the soundness of the capital structure proposed by the 1935 Plan in the hope that a reorganization could promptly be carried through with the support of the larger holders of the Company's securities, particularly bonds, and without substantial opposition.

While gross earnings of the property have materially exceeded those contemplated by the tables prepared by the Financial Vice-President to illustrate the application of the Plan to certain assumed future earnings, and while net earnings also have substantially exceeded those set forth in these tables, the intermediate future and the long term future not only of the Company's properties but of the railroad situation, are now clouded with more uncertainty than was apparent in 1935.

The hoped for prompt reorganization having failed, the committee's conclusion is that those uncertainties make it inadvisable at the present time to take risks of the soundness of a reorganized capital structure which in 1935 seemed to be offset by other considerations.

5152 Accordingly, the committee is unable to recommend to the Board that it instruct the officers to state to the Commission that it believes that the 1935 Plan should now be consummated.

Because of present uncertainties as to the general business situation, uncertainties as to the result of recent requests by railroad labor for increased wages and changed working conditions which, if granted in any substantial part, would result in a radical increase of expenses of operations, uncertainties as to the extent to which the present rising trend of commodity prices will go, uncertainties as to the rate structure which may in the future be applicable in the Company's territory, and uncertainties particularly as to the extent to which it may be necessary to disturb existing First Mortgage liens to provide at the present time any financing medium which could be relied on with certainty, the committee is unable to recommend the proposal at this time of any modification of the 1935 Plan or any new Plan for submission to the Interstate Commerce Commission.

Were the property to be reorganized at this time by providing for financing future requirements through new First Mortgage bonds senior in lien to all the present

bonds, and by drastic scaling of present debt there
5153 would be great risk of the piling up of new debt and the beginning of a new cycle leading to another reorganization at some time in the future.

In the committee's view there can be no certainty that if such a drastic reorganization were accomplished the new First Mortgage bonds would be salable in the near future or in substantial amounts over a long term.

Any such Plan would constitute an extreme shock to the credit of railroad securities,

(1) Through its disturbance of the General Mortgage bonds, which had always been regarded as prime bonds,

(2) Through the drastic treatment which would be required for the 50-Year bonds, more than half of which were issued in the 1928 reorganization to provide new money, and

(3) Through the probable relegation to a common stock status of the Adjustment Mortgage bonds, which were the successors of the old First and Refunding Mortgage bonds, the financing medium prior to the 1928 reorganization.

In the Committee's opinion any such plan of reorganization, apart from its doubtful effectiveness from the standpoint of future financing, would involve such great sacrifices on the part of all classes of present security
5154 holders that there would be small likelihood of gaining their consent.

Apart from this practical consideration, if the present uncertainties should later be favorably resolved, any such drastic plan would prove to have treated with undue harshness present junior bonds and stock.

If any new plan were to have any practical value, it would have to be the result of negotiations with representatives of the security holders, which might be prolonged, and in which, since such a plan could now preserve little, if any, equity for the present stock, the senior securities, with substantial reason, might feel that the Board of Directors had no position.

Indeed, the fundamental philosophy of any such drastic plan would be such that its proposal must necessarily come from the senior interests themselves.

On the other hand, in the committee's opinion it is entirely possible that ultimately the present uncertainties may be sufficiently favorably resolved to permit of the adoption of the 1935 plan without drastic modification.

Accordingly, it is the recommendation of the committee that the officers of the company, counsel to the Com-
5155 pany and the members of the special committee be authorized and directed by the Board, at the hearing to be held by the Interstate Commerce Commission on June 16th, to supply any additional statistical material and information requested by the Commission or otherwise believed by them to be appropriate to bring the record of the factual situation down to date, and to request the Commission for a further adjournment of the hearing upon the 1935 Plan for at least six months.

Mr. Dick then stated that in addition to the matters covered by the foregoing report, as to which there was agreement by all three members of the committee, he felt that further study must be given to the restrictions to be imposed upon the issue of new bonds under any financing mortgage, whether the existing mortgages of the company or any new ones which might be created for that purpose.

Mr. Colpitts stated that in addition to the matters reported and upon which the three members of the committee had been in agreement, he felt that before any modifications of the 1935 Plan or any new plan could properly be proposed, whether by the security holders themselves or by the Board, studies more intensive than any yet made should be made of:

5156 (1) The probable future traffic situation in the company's territory; and

(2) The expenditures which would probably be required to enable the company to hold and carry its proper share of available traffic in the territory in the light of prospective improvements in the industry and of the competitive situation in the company's territory.

He stated, however, that he did not believe that it was advisable, in the present state of uncertainty as to so many relevant factors, to incur the expense of such a study at this time, because of the possibility, if not likelihood, that it would be obsolete by the time the formulation of a new plan would be feasible. He stated that in his opinion it might be several years before any kind of a reorganization would be feasible.

After full discussion, in which all the members of the Board present participated, it was unanimously

Resolved that the officers, counsel for the Company and members of the special committee which has reported at this meeting be, and they hereby are, authorized and di-

rected, at the hearing to be held by the Interstate Commerce Commission on June 16th, to supply any additional statistical material and information requested by the Commission or otherwise believed by them to be appro-
5157 priate to bring the record of the factual situation down to date, and to request the Commission for a further adjournment of the hearing upon the 1935 Plan for at least six months.

Mr. Swaine: Now, if the Commission please, the Debtor proposed to submit each of the three members of the Committee as witnesses in order that they may explain the consideration which led them, as members of the Committee to make the recommendation upon which the Board acted.

This concludes the Debtor's presentation of the testimony through Mr. Scandrett.

Whatever is the wish of the Commission, of course, will be followed, if you want to cross-examine Mr. Scandrett now, or will you prefer that the other three witnesses be called first and then cross-examine afterwards.

Commissioner Porter: Well, I think if there is any cross-examination desired of Mr. Scandrett, it should be made at this time, if possible. Anybody desire to cross-examine Mr. Scandrett on his testimony today?

Mr. Burgess: We have had no opportunity to examine the statistics. I doubt whether there will be any cross-examination on them.

I have one question to ask, not in the nature of
5158 cross-examination, particularly, but to develop the record a little more fully.

Have you given any thought, Mr. Scandrett, to whether or not the public that is served by the Milwaukee Railroad has suffered in any wise by reason of the delay thus far in consummating the plan?

The Witness: Well, we certainly have done everything that we could to prevent any suffering by the public. I don't think it has.

Mr. Burgess: And what have you to say as to the ability of the Milwaukee to borrow money on Equipment Trusts, for example, in the light of the action that the Court has taken, in respect to payment under this Plan?

The Witness: Well, we have sold two Equipment Trusts in the last six or eight months on what we regard as very favorable terms; the lowest cost money that the company has ever obtained, I think.

Mr. Burgess: So that you have had no difficulty in

getting money for those purposes, even though you are in bankruptcy?

The Witness: That is correct.

Mr. Burgess: Those are the only questions I have at this time, your Honor.

5159 Commissioner Porter: Anything further from anybody else? At this time?

Mr. Swaine: That concludes the testimony of Mr. Scandrett.

Shall we start with a new witness now?

(Witness excused.)

Commissioner Porter: It is so near adjournment time, suppose we take a recess until two o'clock this afternoon.

(Thereupon, at 12:30 o'clock p. m., the hearing in the above-entitled matter was adjourned until two o'clock of the same day.)

5160 Afternoon Session, 2:00 p. m.

Mr. Murphy: Mr. Commissioner, I have a petition of intervention here that I desire to file on behalf of the Director of Railroads. I move the petition be granted.

Commissioner Porter: Have you shown those to other counsel present?

Mr. Murphy: No, but I have copies here.

Mr. Bagon: I would like to ask Mr. Scandrett a few questions.

H. A. SCANDRETT, testified further as follows:

Cross-Examination.

Q. (By Mr. Bagon.) Referring to Exhibit 141, Railway Operating Expenses, Maintenance of Equipment, can you tell me what the item of the $480,266 consists of?

Mr. Swaine: You better look at exhibit 142 also.

A. I think that is all explained in 142. Are you talking about the item of maintenance of equipment, $480,000?

Q. That is right.

Mr. Swaine: At the bottom of page 2 of exhibit 142, that is explained in detail.

Q. (By Mr. Bagon.) That is, for new equipment?

A. That is maintenance of equipment.

5161 Q. Yes.

A. That means repairs to existing equipment.

Q. To equipment acquired by the company in the reorganization, which was proposed to have replaced the obsolete equipment of the Milwaukee & Northern?

A. Now, that is the charge that is made for maintenance of equipment against the Milwaukee & Northern as to the equipment that is used on that line without any reference to ownership by it.

Q. What I am trying to arrive at is, under the mortgage, the old equipment should have been replaced.

A. I don't know whether it should have been or not. I understand there is some question about that, as to the requirements of the mortgage, but this has nothing to do with that.

Q. Well, any new equipment that the new company has acquired, they have kept it for themselves and have charged the Milwaukee & Northern depreciation and rental and interest on that equipment; is that right?

A. Well, the Milwaukee & Northern has no equipment, or practically no equipment. There may be some few survivors of what it had originally.

Q. Well, originally they had sufficient equipment?

A. You are telling me?

Q. I am asking you that question.

5162 A. I don't know.

Mr. Bagon: That is all.

A. That is back over fifty years.

Q. (By Mr. Bagon.) One more question. The net earnings of $524,915, that is in addition to the $171,677?

A. That $524,000 is not included, or is not a part—or, I will put, it this way—the $171,677 net income after interest is not a part of the $524,915.

Q. In other words, it is in addition to that?

A. I say, it is not a part of it. It is what it says.

Mr. Bagon: That is all.

Commissioner Porter: Anything further with this witness? That will be all, then, for the present.

(Witness excused.)

Mr. Swaine: Call Mr. Dick.

FAIRMAN R. DICK, was sworn and testified as follows:

Direct Examination.

Q. (By Mr. Swaine.) Mr. Dick, you are a director of the Debtor in this proceeding?

A. Yes.

Q. How long have you been a director?

A. I think it is 1929.

Q. Following the reorganization of 1928, you have taken a personal interest in the situation respecting
5163 the St. Paul securities—even before that, have you not?

A. Yes, sir.

Q. You have been familiar with the problems of the property as an investor and as a dealer in bonds prior to the 1928 reorganization?

A. Yes. I can say I had a general familiarity with the property.

Q. You were a member of the special committee appointed at the meeting of May 14th to consider the question suggested by the Director of the Bureau of Finance' letter of May 4th with respect to the possibility of a new plan?

A. Yes.

Q. And you participated in the deliberations of that committee leading to the report which Mr. Scandrett read into this record this morning?

A. Yes.

Q. Will you be good enough to state to the Commission the reasoning process by which you personally, as a member of that committee, arrived at that conclusion?

A. As a member of the special committee appointed by the board of directors of the Debtor to determine the position which it should take at this hearing with respect to the 1935 Reorganization Plan, I have, during the last several weeks, given intensive study to the various problems involved. For many months before the appointment
5164 of the committee, I had been giving substantial consideration to those problems and was greatly puzzled as to what the proper course for the Debtor should be.

As financial advisor to the Association of American Railroads, I had been giving a considerable amount of my time to the consideration of the financial problems of the rail-

roads generally and in that consideration I could not help but apply my thinking concretely to some of the problems of the St. Paul, of which I am a director.

The report of the special committee as embodied in the minutes of the meeting of the board of directors held June 3, which has been read into the record by President Scandrett, has my complete concurrence. As the committee's report points out, a vital feature of the 1935 plan was the provision in Article VI for the purchase by the Reconstruction Finance Corporation of $12,000,000 of equipment obligations, and the lending by that corporation to the reorganized company of such additional sums as the board of directors might request on or before July 1, 1940, not exceeding an aggregate of $12,000,000. It was upon this provision that the plan depended for additional financing of the reorganized company. The only other financing medium provided in the plan was the issuance of additional bonds secured under the first and refunding
mortgage. Under present conditions, these bonds
5165 would clearly not be salable.

The RFC commitment was by its terms limited to December 31, 1935, and therefore has expired. The Debtor has not taken up with the RFC the matter of whether it would be willing to renew the commitment because of the doubt whether a reorganization at this time should be dependent on RFC financing.

It has come to be my view that while the board was entirely justified in proposing a plan based on such financing in 1935, that it is not true in June of 1937.

I strongly adhere to the view that a reorganization today must be on a basis to insure sound financing of capital requirements for the future without dependence on a governmental agency and that the prompt reorganization which was hoped for in 1935 having failed of realization, one of the primary questions which must be solved in any reorganization is how can the new Company be assured of such funds, beyond those provided by earnings, as may be necessary for those capital expenditures which will be required if the property is either to perform its public obligation or to get its fair share of competitive business.

In 1935, the plan had, as therein stated, been worked out after conferences with representatives of more than
twenty insurance companies, trust companies and
5166 savings banks owning in excess of $100,000,000 of
various issues of bonds affected by the plan. Any

modification of the 1935 plan, even for the purpose alone of resolving this question of future financing, will require similar negotiation.

Negotiations and conferences of this character necessarily consume large amounts of time, not only of the directors and counsel of the Debtor, but of representatives of and counsel for the various creditor interests.

It is neither feasible nor economical for the Debtor to negotiate a whole series of tentative plans with the creditor interests concerned. The part of wisdom clearly lies in not commencing such negotiations until the Debtor is ready to proceed with the negotiation of a revised plan which it may fairly regard as a satisfactory solution of the problem in the light of changed and changing conditions.

While it can be pointed out that the earnings for 1936 exceeded the estimate in the original plan, the marked rise in cost of materials and supplies as well as the demand of the men for higher wages has completely changed many important factors on which the original plan was based.

5167 The difficulties in reaching a proper decision at the present time in regard to a capital structure which will best be adapted to solving the problem of the St. Paul are, in my opinion, insuperable. The problem of creating some method of supplying the St. Paul with the money needed to proceed in the modernization of the new plant which, as I have already stated is the primary problem, cannot be intelligently solved under today's conditions.

Obviously, the first and refunding mortgage is unsalable as the General Mortgage secured by prior lien on the more productive lines is selling at 60, and with the General Mortgage selling at 60, it is obvious that that mortgage is not salable even if the security holders would consent to open it up.

If we assume, for the sake of argument, that this First Mortgage was scaled to 50 per cent and opened up at that figure, even then there is considerable doubt as to its salability under present conditions.

If we assume, however, that such a drastic scaling was feasible and necessary to meet credit conditions, it should be pointed out that the St. Paul debt, scaled to this figure, would stand at a ratio of but approximately 20 per cent of its investment.

5168 If a standard so conservative is deemed to be necessary in order to solve the St. Paul problem today and enable it to survive in the next depression, obviously

further improvements to plant cannot be bonded in excess of 20 per cent of cost, or at least whatever debt is issued in excess of this ratio must be retired by junior financing prior to the next depression so that the road may enter the next depression in the financial condition now decided to be sound.

It must be recognized that such a plan, necessitating 80 per cent of the cost of improvements financed out of earnings and non-fixed interest securities, means a considerably higher level of earnings during prosperity than was formerly deemed necessary for any railroad.

For reasons to be discussed later, it is probably not sound to determine a proper capital structure for the St. Paul on such a conservative basis. On the other hand, if we critically analyze the ability of the St. Paul to finance at the present time even at such a radically low debt ratio and furthermore take into consideration the sharp rises that have already taken place in cost of materials and supplies and the demands of the men for increased pay, not to mention pending legislation, it is clearly evident that even such a drastic scaling might not be effective in the immediate future for raising any money whatsoever.

It must be understood that if the security holders 5169 are to be asked to agree to such a change in their present status, aside from the difficulty of obtaining assents there is a further difficulty of adjusting the relationships between the various securities based on the underlying mortgage making sacrifices which had not been contemplated in the original plan.

If such a radical debt scaling and such a drastically conservative policy for the future were determined to be correct, then it would be advisable at the present time to undergo the burden of adjusting the changed relationships brought about by this drastic policy. However, as already indicated, such a drastic policy may be inadequate for the immediate future and at the same time in the long run unduly burdensome on the public in necessitating the additional cost of an unnecessarily high proportion of what might be termed "speculative money" for future financing.

The Committee's report indicates that the second main question which the members of the committee had with respect to the 1935 plan, had to do with the cumulative feature of the contingent interest to be payable upon the modified 50-year 5 per cent mortgage bonds.

As I see it, that problem ties directly into the first

problem, that is, that as to financing. It seems to me
that in determining what means shall be provided
5170 for future financing, consideration must be given to
the advisability of opening up the contingent interest mortgage as a means of future financing.

Financing by means of a contingent interest mortgage would be a new development in railroad financial practice and it was not contemplated in the original plan. On the other hand, the increased volatility of railroad net earnings in recent years is an obvious fact. This increased volatility is due to the narrowing margin between expenses and revenues and also due to the far greater decline in traffic volume in this depression as compared with other depressions.

This greater volatility means relatively lower earnings in depressions and relatively higher earnings during normal times, and lower earnings in depressions necessitate a lower percentage of financing by fixed interest securities than was formerly thought conservative. To limit the supply of low cost capital in conformity with a conservative debt standard, and then to leap to equity financing even of a preferred variety prevents a railroad from availing itself of a reasonable supply of medium cost money which could be obtained from a class of investors such as certain insurance companies and discount banks, who will purchase bonds adequately protected by mortgage at reasonable rates of interest even where the
5171 interest is not fixed in extreme depressions. For
example, if we assume that 4 per cent would be the cost of fixed interest money, contingent interest money might be obtained at 4½ to 5 per cent, whereas marketing of prior preference or preferred stock would necessitate a charge of at least one-half to one per cent more; in other words, a charge of possibly 5½ to 6 per cent, depending, of course, on the demonstrated earning power of the carrier in question.

There must be considered also the more limited supply of this higher cost, more speculative money. Probably the largest reservoir of funds seeking investment today is of the conservative or semi-conservative type, requiring bonds with fixed interest or contingent interest. If the carriers are prevented from availing themselves of this reservoir of capital to the utmost extent consistent with conservatism, it may develop, at least during periods of extensive railroad modernization, that the supply of higher cost

preferred stock money might not be available in sufficient quantity to satisfy the demands of the railroads, and this would entail even higher costs for this type of financing.

In other words, the whole problem revolves around the devising of methods by which the railroads may maintain conservative standards now deemed advisable and at
5172 same time obtain future supplies of money at the lowest possible cost. The opening of and development of a broad market for contingent interest bonds would seem essential to a sound solution of the problem. If this additional change in the plan is thought advisable it should be pointed out that this also entails treating anew the relationship between the various creditor groups.

If it is determined that contingent interest bonds should be provided as part of the new financing media, then the provisions of the 1935 Plan with respect to contingent interest on the 50-year 5 per cent Mortgage bonds present a difficulty even more acute than that presented by the 1935 Plan itself.

Cumulative provisions, unqualified and unlimited, may result in distortion of railroad capital structures. One of the best examples of that is the accumulation on the adjustment bonds of the St. Paul today, and there can be no doubt that this feature of the St. Paul plan as well as other plans should be restudied, and examined in the light of the advantage of using the adjustment mortgage as a financing medium. It may be advisable and sound policy to limit accumulations to a definite period of years, for example, three or four, and it may be that such a lim-
5173 itation will not injure the security as a financing medium. No investor will buy a cumulative adjustment bond in the belief that large accumulations will develop. The reason for desiring cumulative features is in order that failure to pay interest during a depression will be made up later, and that the bondholder will not be in the position of giving up his interest during a depression and then later, when earnings increase, see the stockholders reap all the benefits.

A limited cumulative feature could probably be devised, adequate to protect the bondholder from making sacrifices in favor of the stockholder and at the same time prevent the accumulations reaching a point where they materially distort the capitalization.

Even if the 50-year Mortgage bonds are to be given fully cumulative contingent interest, it seems to me that

further study must be given to the provision of the 1935 plan that a ten year accumulation of interest on those bonds would constitute a default. This provision was intended to place the bondholders in a position to negotiate and endeavor to bring about whatever adjustments might be necessary if, for a long period of years, actual earnings fell far short of the estimates on which the plan was based.

The purpose of this provision seems entirely sound
5174 but further study may reveal a better means of accomplishing the same results.

For example, if it is determined to open up the general mortgage for a limited amount of future low cost financing, it is obvious that some leeway must be given to management to exceed the standard deemed to be conservative during depressions when junior financing is impossible.

It may be advisable, therefore, to provide for either a technical default or some form of bondholder control in the event that debt was piled up in excess of the limit agreed to by the bondholders in opening up their mortgage.

In such event, it is just and equitable that some suitable provision should enable the bondholders to determine what their policy would be, either, for example, in authorizing a further violation of the standard, or, possibly effecting another capital readjustment through reorganization.

It seems to me also that further consideration must be given to the provisions of the 1935 Plan with regard to sinking funds. These provisions were inserted at a time when there was a great wave of enthusiasm, in part sponsored by the Commission, for sinking funds, particularly in railroad financing. As the Commission now knows,

the Federal undistributed earnings tax creates a most
5175 serious problem taxwise with respect to such sinking funds. Furthermore, I have substantial doubt as to their effectiveness in the field of railroad financing. Studies into railroad economics have revealed the fact that sinking funds will not in fact reduce debt unless either the demands for money for modernization are very much less than they were in the past, or, on the other hand, earnings are far in excess of what they were in the past. During periods of depression, it will generally be necessary to increase fixed interest debt and, as the Commission has frequently pointed out, all debt once issued must not be regarded as permanent.

It is believed that some method for accomplishing the Commission's policy of reducing debt to a conservative figure can be devised through inducing or, in fact, compelling retirement of what might be termed excess debt by junior financing when conditions permit. In this connection, convertible features applying to what might be called excess debt might prove very effective.

The difficulties in framing such a plan of reorganization for the St. Paul at the present time are, in my opinion, insuperable. The problem to be solved is the determination of the type of capital structure which will enable the St. Paul to function in the immediate future and at
5176 the same time given every assurance that the St. Paul will be enabled to weather the next depression. In this connection a most important factor is not only that both these problems should be solved correctly but that they should be solved in a way that will enable the St. Paul to raise its money for modernization at the lowest possible cost consistent with the two principles above mentioned.

Stating the matter in another way, the problem is to devise a capital structure that will correctly conform to the future earning power and variations in earning power of the St. Paul.

Studies into what this future earning power may be, reveal the fact that the St. Paul and, in fact, many of the other roads in receivership have gotten into difficulties to a far greater degree through a low level of earning power than for a high burden of fixed charges.

For example, in 1929, fixed charges on the St. Paul required for service 8.2 per cent of the gross operating revenue received from shippers, whereas for all Class I roads for the same year fixed charges consumed 11.0 cents.

The St. Paul, therefore, was materially stronger than the average of Class I roads in relation to fixed charges.

On the other hand, the number of cents on the
5177 dollar paid by the shipper coming down to net for the St. Paul in 1929 was 15.3 cents as compared with 19.9 cents for all Class I roads.

For the period from 1922 to 1929, out of a shipper's dollar the St. Paul was able to save 12 cents as compared with 17.5 cents for all Class I roads. It is seen, therefore, that in earning power the St. Paul was distinctly inferior to the average. This inferiority in earning power of the St. Paul prior to the depression in itself does not tell the whole story because the St. Paul, along with other roads

of subnormal earning power, produced such earnings as they did under a pressure of economy far in excess of the more prosperous roads.

Less reserve strength, therefore, was available to meet the depression so that the actual weakness of the road was in fact greater than might be indicated by a mathematical demonstration of the vulnerability of a narrow margin between expenses and gross revenues. As a result of the weakness in the margin and the lack of reserve power during the depression, the earning power of the St. Paul suffered a further relative decline.

For the years 1931 to 1936, out of every dollar received from the public the St. Paul was able to retain only 6.5 cents, as compared with 13.9 cents for the average of all Class I roads.

5178 A proper determination of a capital structure for the St. Paul today depends on the extent to which these unfavorable earning factors will be corrected. In this connection, it should be pointed out that these unfavorable factors in regard to the St. Paul are common to many of the roads which have gone into bankruptcy or receivership.

In the Chicago & North Western hearing, Mr. Sargent introduced in evidence maps showing a high concentration of railroad receiverships and bankruptcies in Western Trunk Line territory, and particularly the territory North and East of the Missouri River.

An inspection of this map shows conclusively that this deficiency in earning power and in ability to resist depression conditions is largely territorial. An analysis of the real causes of the disaster would seem to lie in a study of what might be called the territorial factors affecting this group of roads.

Following the North Western hearing I made some further studies into this localization of receivership conditions, and I find that of approximately 70,000 miles of road in receivership today, 43,000 miles are of roads heavily involved in Western Trunk Line territory.

This group of roads is made up of the following: Chicago Great Western, with 100 per cent of its mileage

5179 in Western Trunk Line territory; the St. Paul with 75 per cent; Chicago North Western, including "Omaha" with 100 per cent; Rock Island, with 65 per cent; Minneapolis & St. Louis with 100 per cent; Missouri Pacific with 59 per cent; Wabash with 63 per cent; and

Wisconsin Central with 100 per cent. The true average is 78 per cent.

If we compare this group of 43,000 miles of railway involved in Western Trunk Line territory with the rest of the United States, we find in the Central West but two important roads in bankruptcy or receivership—the Western Pacific and the Denver, with but 3800 miles; in the South we find 8000 miles consisting of the Central of Georgia, Florida East Coast, Mobile & Ohio and Seaboard Air Line.

Turning likewise to the Southwest we find the important carriers are four, with 10,000 miles—the International Great Northern with 1100 miles; the New Orleans, Texas & Mexico with 1700; the St. Louis-San Francisco with 5400; the St. Louis-Southwestern with 1700. Again, in the Eastern district we find the New Haven with 2000 miles, and aside from the New Haven we find but three relatively unimportant roads—the Ann Arbor with 294 miles,—and this is really a part of the Wabash System—and the Chicago & Eastern Illinois and the Monon, with a total of 1500 miles; both these latter roads running south out 5180 of Chicago are on the borderline of Western Trunk Line territory.

This grouping of roads shows roughly that among the important roads in the hands of the court, 43,000 miles are involved in Western Trunk Line territory and 25,000 miles are outside of Western Trunk Line territory.

In an attempt to throw further light on the subject I consolidated certain factors in regard to earnings and burden of debt for these two groups, with the following result. The fixed charges of the Western Trunk Line group in 1929, required 9½ per cent of gross revenues for servicing. The group outside of Western Trunk Line territory required 13.1 per cent of gross revenues to service fixed charges.

Analysis, therefore, in regard to the debt burde would seem to indicate that the wholesale receiverships in Western Trunk Line territory cannot be due to this group's comparative inferiority in capital structure.

The average burden for the country as a whole was 11 per cent.

I looked further into the problem to see if these wholesale bankruptcies could be due to a relatively greater decline in traffic on these roads as compared with the rest of

the country and I find that for the Western Trunk Line roads mentioned above the decline from the pre-
5181 depression period was 42.1 per cent; for Class I roads as a whole it was 42.2 per cent; and for the roads in bankruptcy or receivership outside of Western Trunk Line territory, 43.4 per cent. These figures are based on a comparison of the average gross revenues for the years 1922-1929 with the average gross revenues for the years 1931-1936. It is obvious, therefore, that the reason for the credit disaster in Western Trunk Line territory cannot be found in a relatively greater decline of traffic during the depression.

When we turn, however, to the earning power of the Western Trunk Line group we find that in the years prior to the depression this group was able to bring down to net railway operating income but 12.9 cents for every dollar received, whereas for the country as a whole the comparable figure was 17.5 cents.

For 1936, the Western Trunk Line group brought down 8.0 per cent of gross for net railway compared with 16.5 per cent for the country as a whole.

These general statistics indicate not only the wholesale bankruptcies in Western Trunk Line territory are due to causes lying largely outside the burden of debt and that a restoration of sound credit conditions in this territory can probably not be brought about merely by tinkering with capital structures, but they further point out the
5182 dangers of attempting to restore sound credit conditions by a revision of capital structures when there are obviously involved in the problem other factors so serious as to create grave doubt as to whether a revision of capital structures will even partially improve the situation.

Certainly it would seem the height of recklessness to effect reorganizations of this group of roads without any serious attempt to discover the real nature of the disease that has caused the disaster.

A sound capital structure is sound only if it is adapted to the conditions which it has to meet, and at the present time no evidence is available as to the future course of the disease in Western Trunk Line territory that has brought about the disaster.

If therefore, a capital structure based on present knowledge actually proved to be the best adapted to meet the

conditions of roads in this territory, it would be purely a matter of chance.

On account of the many changes that have taken place since the depression, a thorough investigation would seem to be necessary to determine what the true reasons for the inadequate earnings are today, or what are the proper methods of remedy, but for whatever light it may throw on the subject we mention some of the reasons for
5183 inadequate earnings which were well recognized to be a factor prior to the depression. For example, unquestionably at that time in the various western rate cases it was well demonstrated that the inferiority in earnings in Western Trunk Line territory was not due to the poverty of the territory, the inefficiency of operation or the unduly low level of traffic, but was primarily due to the depressed rate structure.

In the brief of the security holders of March 8, 1926, page 45, the lack of reserve power in that region to meet emergency or adverse conditions was pointed out. I quote from the brief as follows:

"From the investors' standpoint this factor is important, since lack of such reserve power not merely hampers needed improvements which might lessen costs of operation, but actually threatens dividends and in many cases interest also, should anything occur either materially to increase expenses or to diminish volume of traffic."

In the Commission's decision in that case they point out that:

"Rates in western trunk line territory generally are on a materially lower level than rates in other sections of
5184 western territory, including the southwest." • • •

"It is clear that rate increases in that territory, particularly the portion east of the Missouri River, will tend both to produce a more uniform level of rates throughout the west and to benefit directly many of the weakest carriers in the western district."

In view of the record and the Commission's decision, there would seem to be no doubt as to the increased reserve power and improvement in ability to resist depressions that would have resulted in western trunk line territory if increases in rates had promptly taken place.

Whether adequate increases would have eliminated all the receiverships in this territory is, of course, not determinable at the present time as no important increases in general became effective.

In connection, however, with the solution of the present problem, there is no evidence at the present time on which to base a conclusion that a remedy which would have been very helpful if applied in 1926 would in fact be a proper remedy to apply today in view of the changed conditions.

Therefore, a history of the causes of these receiverships in the past does not in itself form an adequate basis for determining what corrections could be made now
5185 or in the future and thus help in planning sound capital structures for the roads in this territory.

In this connection, I submit in evidence an exhibit placed on the record in the Live Stock Case in the Western District and brought up to date.

Mr. Swaine: I introduce that now as Debtor's exhibit No. 151.

(EXHIBIT NO. 151, Witness Dick, was received in evidence.)

The Witness: This is put in to show the earning factors which must be faced if capital structures are to be devised, based on the record during, and in the years prior to, this depression.

It shows that the return on the Interstate Commerce Commission's value from 1921 to 1929 was approximately 3.5 per cent and that from 1932 to 1935 it was approximately 1 per cent.

The purpose of this exhibit is to indicate the conditions which a capital structure will have to meet if it is assumed that the earnings in the next period of prosperity and the following depression will be similar to those of the past. On the other hand, if the causes of the lack of earning power in this territory can be discovered and remedied, the conditions which a capital structure will have to
5186 meet may be entirely different from those indicated by this exhibit. One thing would seem to be clear, and that is, if the earnings of the future continue at the low level of the past no capital structure that can be devised will permanently stand up. This is for the reason that with average earnings both during prosperity and depression of substantially less than 3 per cent, the burden of debt will necessarily have to be continually increased, as no other form of financing will be possible, and with the burden of debt continually increasing, capital structures become progressively weaker.

Two other exhibits are introduced which show the diffi-

culties involved in determining a capital structure best adapted to the St. Paul.

Mr. Swaine: I offer those exhibts as Debtor's exhibits 152 and 153.

(EXHIBITS NOS. 152 and 153, Witness Dick, were received in evidence.)

The Witness: The first of these exhibits shows the adjustment of earnings and expenses and burden of charges for the years 1902, 1924, 1929 and 1936. This exhibit shows that in the reorganization of 1928, the fixed charges were scaled until they consumed the equivalent of 8.8. per cent of the gross amounts paid by the shippers in 1925.

Data as to the year 1902 is included because 1902
5187 was the earliest year in which the St. Paul earned all these charges. Figures for the year 1929 are given and also for 1936. It should be pointed out that in 1902, with $45,000,000 gross revenues, the St. Paul earned more than its present interest, whereas in 1936 with $109,000,000 of gross revenues, it earned approximately but 70 per cent of this interest. It might be further pointed out that in 1902 when the St. Paul was regarded as one of the strongest roads in the country, the burden of charges consumed 13.6 per cent of gross revenues, whereas in 1936 the burden of charges consumed 13.7 per cent of gross revenues. This exhibit indicates that the difficulties of the St. Paul lie largely outside of the burden of debt. The figures for 1936 also show the extreme hazard in estimating the immediate future earnings for the St. Paul. For example, with the burden of debt in 1902 approximately the same as 1936, the St. Paul in the former year could increase its total expenses 32 per cent and still earn its charges. Last year a 10 per cent increase in expenses would practically wipe out all net earned, while a 30 per cent increase in expenses would leave a deficit of $18,000,000 after paying taxes.

It is obvious, therefore, that with such a narrow margin,
increases in rates will be necessary as substantial
5188 increases in expenses become effective and likewise accurate forecasts here are hazardous.

The next exhibit, No. 153, is put in to throw additional light on the matter by showing the income of the St. Paul in 1883, 1929 and the present day, in connection with the amount of money necessary for serving its underlying interest. The year 1883 is chosen because in that year, with gross revenues of $23,000,000 the St. Paul earned

all its present underlying interest. In 1936, with gross revenues of $109,000,000, the St. Paul likewise earned its underlying interest, but with no margin of safety. These charts are presented to throw light on the problem and to demonstrate that with the maladjustments that have developed in the economy of the St. Paul, a cure cannot be found in a scaling of charges no matter how far back you scale. On these charts are given certain figures indicating the tremendous increase in efficiency of operation that has resulted from the modernization of plant in the past.

It is because of the considerations which I have thus pointed out, taken in the light of all the uncertainties mentioned in the report of the special committee to the Debtor's board, that I feel that a reorganization of the St. Paul property can neither intelligently nor fairly be had under the conditions now prevailing.

5189 How soon these conditions will have changed sufficiently to permit reorganization, I would be rash to predict. I may say, however, that I am an optimist with respect to the future of the railroads and would be hopeful that some time during 1938 conditions would permit the Board, with the cooperation of the principal security holders, to suggest modification of the 1935 Plan which it would be hoped would commend themselves both to the Commission, as the guardian of the public interest, and to the security holders, interested in the preservation of their private investments and the proper recognition of their respective relative priorities. For that reason, I join in urging an adjournment of at least six months, although in frankness I must state to the Commission that I believe that six months from now another adjournment may be necessary.

Mr. Swaine: That is all the Debtor has with this witness?

Commissioner Porter: Any cross-examination?

Mr. Burgess: No cross-examination.

Mr. Stewart: I have a question I would like to ask the witness.

Cross-Examination.

Q. (By Mr. Stewart.) Mr. Dick, have you determined, in view of the possible postponement, until 1938 of the
5190 proposed plan of raising the payments on the general mortgage?

A. Well, I have been hopeful that they could be raised, but to say that I have made a forecast of when they could be raised actually, in view of the present complete uncertainty as to the future, no.

Mr. Swaine: That is a matter entirely within the control of the court; not within the control of the board, I take it?

A. I should think so.

Mr. Stewart: That is all.

Mr. Swaine: That is all.

(Witness excused.)

W. W. COLPITTS was sworn and testified as follows:

Direct Examination.

Q. (By Mr. Swaine.) Mr. Colpitts, you are a director of the Debtor in this proceeding?

A. I am.

Q. You have been a director for how long?

A. Since the reorganization in the first part of 1928.

Q. Have you had a professional connection with the property prior to that time?

A. Yes. I made a report on the property for the reorganization management in 1925.

5191 Q. You say you made a report. You mean, an engineering and financial report?

A. Yes.

Q. In connection with your report, you have made a very careful study of the physical condition of the property?

A. Yes, sir, I did.

Q. And of the amounts that would be necessary to be raised for getting the money in connection with the reorganization at that time?

A. I did.

Q. You were on the special committee of the board to consider the position to be taken by the company at this hearing, were you not?

A. Yes.

Q. You participated in the recommendations made by that committee to the board and read into the record by President Scandrett?

A. I did.

Q. Will you please state to the Commission the reasons which impelled you personally, as a member of that Committee, to reach the conclusion which the Committee reached?

A. A sound reorganization of the St. Paul Railroad is much more difficult to achieve today than was seemingly the case in 1927. From the standpoints of adequate
5192 service to the public, fair treatment of its investors, both old and those who may be induced to buy the new securities, and the effect upon the investors in the securities of many other railroads, it is essential that the St. Paul be placed in a position to obtain the large amounts of capital needed for future improvement of its property upon reasonable terms without doing violence to the present securities. These, to my mind, are the main problems involved in the reorganization of the St. Paul.

For the sake of brevity, I should like to put my statement on this subject in the form of direct questions and answers.

(1) Is the public service the St. Paul performs essential to the future growth and prosperity of its tributary territory?

I would say that, with minor qualifications, the answer is emphatically yes. The qualifications refer to short sections of branch lines that have outlived their usefulness, and possibly to sections of the main line which closely parallel other lines and which might well be consolidated for operation as a measure of economy.

It would be nothing less than a national calamity if, by any process that can be imagined, the St. Paul should be obliterated, or even if its ability to perform its func-
5193 tions should be extensively curtailed, and the territory it serves were obliged to rely upon other railroads or upon other transportation agencies. I believe also that this statement applies with equal force to the lines in each individual state, as well as to the property as a whole.

Without further argument, it can be said the St. Paul performs absolutely necessary public service in its tributary territory.

(2) Is there any other transportation medium that may be expected in the course of time to replace the St. Paul?

In the past thirty years, we have seen the development of two new transportation agencies and their growth to

tremendous proportions—the automotive vehicle and the airplane. We have spent enormous sums of money on our highways for the accommodation of the former and have done a great deal toward promoting safe travel by air. We have built the Panama Canal and have greatly improved and extended our national and international waterways.

In the development and construction of these new means of transportation, more particularly the hard surface highways, new traffic was created for the railroads, a part of which was temporary and part permanent, but on the other hand the operation of these new transportation agen-
5194 cies has resulted in the diversion of a considerable volume of traffic the railroads otherwise would have moved. The St. Paul has been no exception in these respects. The extent of the traffic moved by agencies competitive with the railroads in the St. Paul's territory, compared with that handled by these railroads, is not definitely ascertainable, but it can be stated positively that if the burden of moving the traffic handled by the railroads in this area were shifted to other forms of transportation complete demoralization would result.

It is, of course, possible to move a larger volume of traffic by highway, water and air than is moved by these means at the present time and without a great increase in facilities other than movable equipment, but any extension of such operations on a grand scale to furnish transportation equal to that of which the railroads are capable could only be accomplished at prohibitive cost, both in providing the additional fixed facilities and movable equipment required, and in moving the traffic.

As one who is interested in every form of transportation, I can say that the railroads are now and, so far as one can see into the future, will continue to be the country's main reliance for the transportation of its products. There is no reasonable prospect that the service performed by the
5195 St. Paul, in whole or in large part, can be performed by any other transportation agency; nor can it be said that there is any type of transportation machine in prospect, or even on the most distant horizon, that could conceivably perform the service that does the St. Paul.

If this is a correct statement, and I believe it will not be disputed, the St. Paul is absolutely essential to the future growth and prosperity of the territory it serves and must, whatever the cost, be maintained in full strength and vigor

in order properly to perform its functions as the main transportation medium of that territory.

(3) Is the St. Paul at the present time in a rundown condition?

Up to 1917 the credit position and revenues of the St. Paul were such as to permit of adequate maintenance of its lines and to provide for such improvements and betterments of the property as sound railroad engineering practice demanded.

The seven years following, that is, from 1918 to 1924, which began with 26 months of Federal control, were marked by rising costs and generally disturbed business conditions, and, with fixed charges mounting steadily and with proportionately smaller amounts of net income
5196 available for their payment than had been the case in prior periods, expenditures for improvements were curtailed. As a result of diminishing net income and various other causes, the company was placed in the hands of receivers in March, 1925. In the reorganization of January, 1928, large sums were provided for making good deferred maintenance and for improvements and betterments of the property.

In the two years which followed, 1928 and 1929, with the exception of the year 1920, the operating revenues were the highest in the history of the company, and adequate sums were spent for maintenance and the property generally was considerably improved.

In the first year of the depression, however, the revenues declined markedly and continued downward at an unprecedentedly rapid rate until, at the low point in 1932 and 1933, they were less than 50 per cent of the 1928-1929 average. In 1936, they had regained some part of the loss and stood at 63 per cent of the 1928-1929 figures.

Because of the greatly diminished earnings, and for no other reason, maintenance expenditures were kept at an extremely low level throughout the whole of the depression period, but more particularly during the years 1932, 1933 and 1934. In these three years, they were approximately half the average of the amount spent between 1925
5197 and 1929.

During this time, railroad maintenance engineers in all parts of the country put forth the most strenuous efforts and used every known means for reducing expenses within proper limits of safety and without subjecting their respective properties to the danger of permanent injury.

In this emergency, the engineers of the St. Paul contributed to the general railroad welfare in an important degree by devising ways and means for safely reducing maintenance costs with the sole and admirable purpose of assisting in weathering the depression. I have not made a personal inspection of the property in recent years, and I fully appreciate the fact that, for a given volume of traffic, maintenance man-hours have been permanently reduced and that, therefore, an examination of maintenance expenditures alone will not disclose the facts with respect to the true condition of the property.

From this restricted viewpoint, I feel that deferred maintenance has accrued on the St. Paul, as is the case on many other lines which have been obliged to pursue a similar policy, and must be made good in due course as the traffic approaches that of the pre-depression period.

I would say, therefore, that the St. Paul is not in a run-down condition, but that, in the light of the
5198 greatly reduced amounts spent for maintenance in the past several years, a reorganization plan should not be predicated on the assumption that there is no deferred maintenance.

Unfortunately, from the standpoint of money requirements, the condition based on its present or pre-depression physical standards does not, to my mind, furnish a correct measure of the future needs of the property. During the depression, as perhaps never before in the same period of time, improvements have been perfected in machinery, in equipment and in track structure, some devised to reduce operating costs, others to induce new traffic.

The subject is one to which the most intensive study has been given, not only by railroad officers but by supply companies and by others not heretofore concerned with railroad operation. The improved service to the public in the speeding up of passenger and freight trains has met with great popular favor and, while it has been effective in reclaiming traffic from the highways and waterways, it has also induced the keenest competition between the railroads and other transportation agencies, and between the railroads themselves.

The fact must be squarely faced, therefore, that a railroad in the position of the St. Paul must maintain
5199 standards both of track and equipment equal to those of its stronger competitors if it is to continue to hold

the place it has occupied in the past. To do this will require the expenditure of large sums of money from year to year to keep pace with the present and probable future rapid developments in railroad practice, and to my mind it is highly important to know what these capital requirements are likely to be.

(4) What are the causes of the successive failures of the St. Paul?

To answer this question fully would take a great deal of time and, in some respects at least, would enter controversial ground.

My own opinion is that the troubles of the St. Paul began with the building of the Pacific Coast Extension. In making this statement, it is not my intention to question the wisdom of the decision to extend the line to the Coast in the light of the conditions as they existed at the time that decision was made.

Trade with the Orient was expanding rapidly, and industrial, lumbering, farming and mining developments in the Northwest were proceeding at a rapid rate. The need for additional transportation facilities to keep step with and promote further activity in these directions seemed apparent. With the opening of the Extension in 1909,
5200 operating revenues showed an immediate and marked rise. In fact, the revenues of the company have continued to increase with more or less regularity up to the beginning of the present depression.

For many years prior to the building of the Extension, and continuing until 1911, the company had paid 7 per cent dividends on both classes of stock. It had successfully weathered a number of severe depressions and was generally regarded as one of the most prosperous roads in the country.

That the opening of the Extension imposed a burden upon operations is shown by the fact that the ratio of expenses to earnings immediately increased, and it now would appear that the increase in revenues, insofar as it was due to the operation of the Extension, was accomplished at too great cost, even though its construction had been financed largely by the same of stock. With deficits beginning to appear after the payment of regular dividends, the dividend on the common stock was reduced, and in 1917 dividends on both the common and preferred were suspended and have not since been resumed.

Other causes, of course, affected the operations, some detrimental, others beneficial; but in general it is apparent as we look back that the road entered Federal control in a somewhat weakened condition as a result
5201 of the burden it had assumed in the building of the Extension.

As I view it, the real difficulties of the St. Paul were imposed by a factor which seems to have been wholly underestimated in the decision to extend to the Coast, namely, the effect of the building of the Panama Canal upon the transcontinental traffic which the Extension was designed primarily to carry.

It was not, however, until after the War and Federal Control that the Panama Canal became a serious competitor for transcontinental traffic. By 1920, the tonnage moving through the Canal had reached substantial proportions and from that time on has grown rapidly. The diversions that were not fully anticipated not only include traffic moving between the eastern seaboard and the Pacific Coast and the Orient, but between inland points far removed from either coast.

The steady diversions of this traffic almost before the road had established itself as a transcontinental line was a severe blow.

Following on the heels of this diversion of through freight traffic came the vast increase in the utility of the automobile with the extension of hard surface roads, which caused a steady decline in passenger revenues on every railroad in the country, those of the St. Paul fall-
5202 ing from a peak of $31,000,000 in 1920 to about one-fifth of that amount in 1933.

Like all other railroads, the St. Paul has suffered from the competition of motor trucks.

The frequent failures of crops in the territory, with the resultant loss of inbound traffic and the diminished activity in mining have contributed to the difficulties of all lines serving this area.

The low level of rates in Western Trunk Line territory has been responsible to some extent for the relatively low earnings per mile of line.

These, to my mind, are the main causes of the receivership of 1925.

The failure of the road again in 1935 can be ascribed to one cause—the depression.

(5) What has been the experience of investors in St. Paul securities?

Throughout the 44 years from 1874 to 1917, the company enjoyed an unbroken record of 7 per cent dividends on its preferred stock, except in the years 1888 and 1889, when the rate was reduced.

From 1879 to 1917, 39 years, continuous dividends on the common stock were paid, except from 1889 to 1892, at rates varying from 2.5 per cent to 7 per cent, with long unbroken periods at the 7 per cent rate.

5203 Up until the time the Coast Extension was opened, and for two years afterward, comfortable sums were set aside for improvements and betterments after the payment of these dividends.

The ability of the company to weather the business depressions of this long period and pay dividends tended to establish a sound credit position and, as a consequence, the company's securities were highly rated by the investing public.

Between 1901 and 1909, 660,000 shares of preferred and 690,000 shares of common stock, representing about 60 per cent of the total capital stock outstanding at the present time, were sold to stockholders at par, $100 per share.

Since 1917 no dividends have been paid on either class of stock.

In the reorganization of January, 1928, following the 1925 receivership, some $230,000,000 of bonds were exchanged for new junior bonds and about $70,000,000 of new money was provided by the stockholders at the respective rates of $28 and $32 per share of preferred and common stock, for which they also received about $60,000,000 of new junior bonds at par.

Of the total of new junior bonds so issued $106,000,000 represents fixed interest bonds, on which interest is

5204 now in default to the extent of about $13,000,000.

The balance are adjustment bonds on which interest has accumulated to the amount of about $66,000,000. In addition, the interest on the general mortgage bonds, which are a first lien on the eastern lines of the system, are in default to the extent of about $9,000,000.

The total investment in road and equipment of the St. Paul, including the Terre Haute line, less depreciation, is $665,000,000.

At the present time, the securities representing this investment which receive a full interest return are:

Equipment trust notes, RFC and RCC Notes	$ 47,000,000
Milwaukee and Northern Bonds	7,000,000
C. T. H. & S. E. Bonds	22,000,000
	$ 76,000,000
Securities receiving partial interest are the $139,000,000 of General Mortgage bonds, on which two-thirds of the coupon rate is being paid, say, for comparison	93,000,000
Total, representing 27 per cent of the investment	$169,000,000

That is to say, the investor today is receiving a return on the investment in the property of about 1.12 per cent per annum, as contrasted with about 5 per cent per annum in the years of the company's prosperity.

5205 (6) Is sufficient information available at the present time upon which to base a sound reorganization of the St. Paul that will enable it adequately to serve the public in the future and, at the same time, do justice to the present security holders?

To my mind, the answer to this question is decidedly no. As I see it, the St. Paul situation is full of uncertainties. We know the record of the past, and the record of recent years is neither pleasing nor particularly helpful as a guide in planning for the future. It is true that many of the most important uncertainties can only be resolved by time. Others are, I think, of such a nature as to permit of defining them within limits sufficiently narrow as to enable us to formulate plans with respect to them.

Let us take, for instance, the matter of the needs of the physical property. I have stated in answer to question (3) my view on this subject, and I would like to add that I can foresee the gradual raising of standards on the stronger roads. This process has been under way for several years and will continue with increasing impetus as revenues expand, and the roads which show an indisposition to follow the same course, whether because of lack of funds or for any other reasons, will find their competitive

5206 position growing steadily more difficult.

The urge to invent new processes and methods for reducing expenses or expanding traffic which the depression generated is, in my opinion, not likely to subside. Already the benefits to be derived from them are being generally recognized. Modernization of this character is a more or less continuous process, but I believe it will be much more rapid in the near future than it has in the past and will call for the expenditure of large sums of money.

It is apparent now that, with the improved prospects for traffic this year, the requirements for equipment for the St. Paul have far outstripped the estimates made in 1935.

At the time the Directors' Plan was proposed in July, 1935, and with its prospects for early promulgation, it was felt that the cost in time and money of making studies with respect to the property was unwarranted. In the present situation I feel that all parties concerned are entitled to all information that will throw any light on the future requirements and prospects of the company before the attempt is made to prepare a plan of reorganization.

In my opinion, a survey of the physical property, both road and equipment, should be made. We should know the plans and purposes of competing lines, insofar as they can be ascertained, with respect to modernization, so that we may form some estimate, however, rough, of the cost of preserving the St. Paul's competitive position. And we should know these approximate costs, not on the basis of 1929 physical standards, but on the basis of the new standards many roads have already adopted or are preparing to adopt.

Some knowledge of what these costs of restoration and modernization will be I regard as essential now to the formulation of a reorganization plan.

I believe also a survey of the industrial and agricultural situation in the local territory would be of value in the preparation of a plan. Such a survey need not necessarily be exhaustive, but sufficiently so to indicate in general terms the traffic that may reasonably be expected from these sources over a period of years and the extent to which lean years must be bridged. It should show the St. Paul's participation in this traffic in the past in comparison with its competitors.

The studies of the management of the effect of automotive competition and the direction of its growth, should

be included and should indicate the particular traffic it would be desirable to regain and the cost
5208 of doing so.

The rate structure in Western Trunk Line territory should be again reviewed from the standpoint of possible adjustments that would be helpful to the railroads in this area.

These are some of the problems that await study and solution to whatever extent they are soluble. Other studies which are currently made by the management should be incorporated for such light as they will throw upon the situation. They include the through traffic situation, possibilities for the extension of superior passenger service, abandonment of unprofitable and unnecessary lines, reduction or increase in service, joint use of lines and other facilities, etc., etc.

If the present security owners are to be asked to make the sacrifices the Directors' Plan proposes, or in fact any plan that will enable the company satisfactorily to serve the public, I believe they are entitled to know the full facts concerning the property, the amount of money required to enable it to hold its competitive position and its prospects for the future insofar as they can be determined.

(7) Are the directors justified in promulgating a plan at the present time?

In the answer to the previous question, I have tried
5209 to indicate some part of the information the present security holders are entitled to have with respect to the property, in view of the fact that two receiverships of this great railroad have occurred within ten years of each other.

An examination of the income account indicates that the depth of the depression, so far as the St. Paul was concerned, was reached in 1932, in which year there was an actual deficit before bond interest of $288,000. The amounts available for bond interest each year since the 1925 receivership were as follows, in thousands—1925, $15,583; 1926, $16,345; 1927, $10,938; 1928, $30,498; 1929, $29,076; 1930, $17,902; 1931, $9,190; 1932, $-288; 1933, $8523; 1934, $6391; 1935, $4364; and 1936, $8,861.

From 1931 on, total maintenance expenses were severely reduced, as I have already shown, and in 1933 and 1934 maintenance of way expenses were cut to the bone, which accounts very largely for the marked improvement in net earnings in those years over 1932. With social security

and railroad retirement taxes of over $2,000,000 in 1936, and with much heavier expenditures for maintenance, though still not nearly equal to those of pre-depression years, and with the surcharges which have since been largely eliminated, the net earnings of 1936 stood
5210 at about the 1931 and 1933 levels.

The complete figures of the income accounts of these twelve years not only tend to confirm my belief that a survey of the physical property is necessary to determine the extent of modernization requirements, but they show clearly that the road has not nearly recovered its former earnings status, either in gross or net.

Of course, it is not necessary that the earnings be restored before a reorganization plan is promulgated. The difficulty to my mind is that, because of the greatly disturbed conditions of the depression period, the figures of earnings are only confusing, unless related to the facts concerning the physical property. Unless this relationship is determined, the figures of earnings and expenses are practically useless as a guide for the future.

Because of this situation and the many other great uncertainties that impinge on the whole question of the nature of a plan that should be proposed to the security holders, I am of the opinion that the present is not a proper time to undertake it.

(8) Is it possible at this time to promulgate a plan of reorganization that will treat present security holders fairly?

No one, of course, can answer this question with
5211 assurance. My feeling is that if a plan were promulgated now and was later found to have treated the present security holders fairly, it would be accidental.

I do not believe that an all-time peak of business activity was reached in 1929 in this country, or even in the Northwest. This country has shown remarkable recuperative qualities after every depression in the past and has continued a strong upward trend. Despite the severity of the present depression, we are already part way on the road to complete recovery.

If a plan were promulgated now, framed in an attitude of mind that is rightly or wrongly pessimistic after seven years of depression, with great uncertainties before us, many of which are bound to be resolved satisfactorily, it is my feeling that an injustice will be done to junior security holders who have already suffered tremendous losses.

On the other hand, if a plan promulgated now should turn out in a few years to be unsound because not sufficiently drastic, another receivership will follow with further loss to security holders.

My personal feelings of optimism for the future may be unjustified. Nevertheless, I believe the uncertainties of the present and of the immediate future are so great as not to warrant the attempt to measure them at this
5212 time, as a plan of reorganization necessarily does.

(9) Could a satisfactory medium for future financing be created now, and one that would possess every feature of safety the buyer would demand?

Here again, I cannot answer this question with assurance. I feel reasonably certain that no new financial mortgage could be injected into the Directors' Plan head of the General Mortgage that would not so shock the holders of present securities as to make the new mortgage itself unsalable and put a blight on railroad securities generally.

I also feel that at this time, and probably for many years to come, no equity security can be devised that investors would purchase.

In no event should the process of providing new money for the St. Paul, in the large amounts that I believe will be required, demand replacing present bonds with stock only to build up another load of debt which the operations at some future depression period would not be able to sustain.

At the present time, the future is so clouded with uncertainty I feel that no new financing medium can be created that will possess the necessary elements of safety, and consequently of salability, that will not do violence
5213 to the present securities. On the other hand, given time for the clouds to pass, this difficulty may be removed.

In closing this statement, permit me to say that the situation of this railroad, and to a greater or lesser degree of all railroads, is anything but static. A change for the better may come rapidly or it may be slow—no one can tell.

To my mind, the whole question of the future of many railroads as a reservoir for the investment of private capital is at stake in the St. Paul reorganization. Like other railroads, its traffic rates and the wages it must pay its employes are beyond the control of management. The through traffic has been largely diverted to the Government-owned Panama Canal, and its principal competitors

for local traffic are operating on first class Government-owned highways. This is the nature of the competition that represents the business chances an investor takes in providing a railroad in this territory with money today; and if his only hope of a return is by crushing an earlier investor, he must not be surprised if his own turn comes sooner or later. Certainly, if the expectations of the investor in this railroad for the future are no more than a
5214 continuation of his experiences in the recent past, no investment advisor would be justified in urging him to provide additional capital.

It is not my own belief that these are the only prospects for the investor, but I feel he is entitled to greater assurances as to the future than are possible now before he is asked to make further sacrifices or to provide additional capital.

It may be that the Northwest of itself cannot now afford to pay the return to which private capital is entitled in providing modern high class railroad service. If these are the conditions, coupled with the competition and restrictions to which railroads in general are subjected, it is a question as to how long roads hampered as is the St. Paul, can survive without Government assistance.

At the moment, as I see it, one thing only is certain and that is that a financial structure for the St. Paul must be built in such form as to attract large amounts of private capital, it must be supplied from some other source. The St. Paul is absolutely necessary to the future growth and prosperity of its tributary territory and cannot be replaced by any other type of carrier.

Whatever the source of the money required for the purpose, the road must be preserved as a modern and efficient transportation machine, because, whether the North-
5215 west of itself can support it or not, the public needs of that great area must be served, as otherwise the loss to industry would be far greater than the cost of furnishing adequate transportation.

My thesis is that the time is not ripe to undertake the framing of a new financial structure for the St. Paul.

Mr. Swaine: That is all with this witness. Cross-examine.

Examiner Jameson: You referred to deferred maintenance on the property.

A. Yes, Mr. Examiner.

Examiner Jameson: Have you any gauge to that for estimate, as to the amount?

A. Mr. Examiner, I have not. I have not been able to—I have not made any professional examination of the property. I have only been able to judge from the amounts that have been spent and my general knowledge of railroad situations, that in my feeling there is a certain amount of deferred maintenance. How much, I could not say.

Examiner Jameson: But you don't think that that has been made up during 1936?

A. I would not say from an examination of the figures that it could have been made up.

5216 Examiner Jameson: Well, the Debtor introduced an exhibit here, 121, showing expenditures for the next four years. Is it your idea that that would cover the deferred maintenance?

A. I could not say, Mr. Examiner. These men who are in direct contact with the property, of course, know a great deal more about it than I do. I have not been over the railroad for several years. They have. They are working with it all the time. Normally I would be inclined to accept their views that there is no deferred maintenance, but I can't help a lurking feeling that railroad men are so proud of their own railroads, that they don't like to think that there is any such thing as deferred maintenance on their railroad.

May I add, Mr. Examiner, I don't think that is the important question here. I think the new ideas with respect to railroad standards is the big item; that that is the thing that is going to require a great deal of money in the future.

Commissioner Porter: As you exemplified by air-conditioning, streamlining and all those things?

A. Well, that is passenger traffic.

Commissioner Porter: Yes, but in a measure, somewhat the same thing is applicable to freight?

A. Yes, sir. I think we are going to see great

5217 progress in the art of railroading in the next few years.

Commissioner Porter: Anything further? I guess that is all, Mr. Colpitts.

Mr. Swaine: Mr. Davis, please.

(Witness excused.)

HOWLAND DAVIS, was sworn and testified as follows:

Direct Examination.

Q. (By Mr. Swaine.) Mr. Davis, what is the name of your firm?

A. Blake Brothers.

Q. And that firm represents, does it not, certain Dutch stockholders of the Debtor?

A. Yes. It represents certain Dutch administration officers, one of which is a registered holder of the stock of the debtor company.

Q. How much stock does that particular Administration office hold, of record?

A. As of last week I was advised that that particular Administration office was the registered holder of 104,560 shares of common stock, or voting trust certificates for common stock, and 53,797 shares of preferred stock, or voting trust certificates for preferred stock.

Q. You were put on the board as the immediate representative of that block of stock, were you not?

5218 A. Yes, I was.

Q. How long have you been on the board?

A. Since 1929.

Q. You were a member of the special committee appointed by the board at its meeting on May 14th to consider the attitude which the debtors should take at this hearing with respect to the July, 1935 plan, were you not?

A. I was.

Q. You participated in the meetings of that committee which resulted in the report given to the board at the meeting of June 3rd?

A. I did.

Q. Will you please state to the Commission the reasons which impelled you personally, as a member of that committee, to reach the conclusion expressed in that committee's report?

A. My directorship in the Milwaukee road is the only railroad connection that I have, and that fact, together with my previous testimony, will indicate that I am unable to qualify as an expert on railroads.

I am, therefore, trying to speak for stockholders who do not have the contractual rights enjoyed by the holders of senior securities but who are the owners of the property.

May I turn for a moment to an inspection of the
5219 property which they own. I am told that a recent valuation of the property filed with this Commission sets the figure at slightly in excess of $704,000,000.

If we calculate all the bonded indebtedness of the road, including the adjustment mortgage bonds, at its face value, and calculate the preferred stock at its par value of $100 a share, and calculate the common stock which has no par value at $100 a share, we arrive at a total capitalization of approximately $700,000,000. It therefore appears that this total capitalization even calculated on this basis is backed by sound assets in property. These stocks do not represent water. I believe it is also true that this property is in good condition and prepared to render a useful public service. This public service is today taken for granted by the public. Railroads are no longer a strange miracle of transportation facilities, but have become an accustomed part of the landscape, and are taken as a matter of course.

Nevertheless, the service which they render is greatly needed and should receive a reasonable adequate return. It also appears that the property is well managed in the hands of the present trustees.

The stockholders therefore appear to have an owner-
ship in a valuable property, which is providing a use-
5220 ful public service, and which is not being allowed to deteriorate.

The stockholders do not deny their debts or the rights of the bondholders, and, in fact, before the application of June, 1935, they borrowed very considerable sums of money largely for the purpose of being able to continue interest payments to their creditors.

But, when the present plan was submitted it contemplated fixed interest charges in excess of the then existing earnings, and also contemplated a large amount of contingent but cumulative interest.

Such a plan would put stockholders in an even worse position than the position in which they already found themselves, because these full interest charges could not possibly be met and would shortly accumulate in large amounts.

The earnings of the road, however, have shown encouraging improvement, and given time to further demonstrate the possibilities of the property might soon reach a point on which a more reasonable plan could be formulated.

The bondholders must be more interested in the eventual soundness of the property, and the eventual payment of

their debt than they are in the present payment of their full interest.

5221 The plea of the stockholders whom I represent is that the trustees be given time to demonstrate the possibilities of the road in a reasonably normal period, and to resolve some of the uncertainties in regard to rates, labor and taxation which now exist, and which make a forecast of the future so very difficult at the present time.

It may be said that the stockholders have already had time to demonstrate the normal operation of the road, but looking closely at recent past history this seems hardly true, for is one considers the period of the road's extension to the Pacific Coast, which was closely followed by the opening of the Panama Canal, which, in turn, was closely followed by the war and the period of Government operation, which in this case was closely followed by a receivership and reorganization, which in turn was closely followed by a period of great depression, I think it is fair to say that except for one or two years immediately following the reorganization of 1928 this road has not had a period of normal operation on which a sound plan for the future can be based.

The stockholders for whom I speak hope that reorganization plans will be delayed until they can be based on further experience, and can be set up with some rea-

5222 sonable certainty that they will be fair to all classes of securities and will stand the test of time.

These stockholders feel that a reorganization made at this time would of necessity subject them to a sacrifice which, in view of the value and potential earning power of their property, is not justified.

Mr. Swaine: Cross-examine.

Cross-Examination.

Q. (By Mr. Burgess.) Mr. Davis, these figures that you gave of the amount of stock owned by the Dutch Administration on Tuesday of this week, as I understand it, was 104,000 shares of common and 54,000 shares of preferred?

A. Yes; 104,560 shares of common and 53,797 shares of preferred.

Q. That was not the holding of the Dutch Administration at the time that this road went into bankruptcy, was it?

A. In June, 1935?

Q. Yes.

A. I have not checked it, sir, but I don't think it could have been exactly the same, because it is a fluctuating amount.

Q. Well, I have before me the annual report of the Chicago, Milwaukee, St. Paul & Pacific and its trustees to the Interstate Commerce Commission showing that as of April 25, 1936, the Dutch Administration at that
5223 time held 30,220 shares of common and 15,150 shares of preferred. That would indicate, would it not, that the Dutch Administration had been buying both the common and preferred during this period of bankruptcy at these depressed prices, would it not?

A. No; it would not.

Q. Why not?

A. Because your figures mention only the stock which they held and omit the voting trust certificates which they held.

Q. How many would that be; what are the facts?

A. My figures at the present time show that they hold in common, 36,420 shares of stock.

Q. 36,000?

A. 36,420.

Q. All right.

A. And 68,120 shares of voting trust certificates for stock.

Q. How about the preferred?

A. 15,550 shares of preferred and 40,247 shares of preferred in the shape of voting trust certificates.

Q. Do you know whether the Dutch Administration has been buying or selling either the common or preferred during this period of bankruptcy?

A. Under its articles of incorporation the Dutch
5224 Administration may not, for its own account, either buy or sell.

Q. How would the holdings then change?

A. Yes, sir.

Q. If they could not buy or sell, how could they change?

A. They change because of their fluctuation of ownership.

Q. Then, do you know whether those whom the Dutch Administration represent have during this period been selling common or preferred stock.

A. Since what date?

Q. Since the date of bankruptcy.

A. It is my recollection, which I have not checked, that the holdings have slightly declined.

Mr. Burgess: Thank you.

Commissioner Porter: Anything further from this witness from anyone? That seems to be all.

(Witness excused.)

Mr. Swaine: Now, if the Commission please, that concludes the record for the Debtor at this stage, and in accordance with the resolution of the board of directors of the Debtor, which has been made a part of the record, the Debtor requests that the hearing on the 1935 Plan be adjourned for a period of at least six months.

Mr. Burgess: Is it appropriate at this time to make a statement on behalf of the group of institutional investors that we represent?

5225 Commissioner Porter: I think so.

Mr. Burgess: It will be brief.

At the initial hearing before this Commission in this proceeding, the debtor submitted a plan of reorganization. The position of the bondholders group was that that plan constituted a fair and feasible stand-by arrangement for a period of economic readjustment.

The group's attitude toward it at that time was expressed in part as follows:

"In the light of the actualities of the present situation, this group views the plan with favor, provided it can be adopted and accepted promptly so as to preserve its essential purposes, including the various protective provisions which have been incorporated in it."

In the period of almost two years which has elapsed since the submission of the plan, many of its features have been given practical effect, and in that respect this plan has substantially been a standby plan.

Nevertheless, the prompt reorganization of the property on the basis of that plan which this group themselves viewed with favor, has not been effected. As a result it becomes necessary now for us, as well as the Commission itself, to appraise the situation anew. We shall be 5226 greatly aided in doing this by a pretty thorough study and digest of the very comprehensive data which the Debtor has submitted here at the request of the Commission.

The plan pending before the Commission was in no sense our plan. It was proposed by the Debtor and acquiesced

in by our group as a standby plan, with the proviso that if it could be adopted promptly pursuant to the processes of law, we would agree thereto for the reasons stated at the previous hearing at pages 514 to 519 of the record.

Exhibit 120 introduced in evidence this morning shows that the actual operations during the period January 1, 1937, were more favorable to the operation of the plan than contemplated when it was originally introduced.

While, of course, the condition previously attached to our consent has not been met, that is, the plan has not promptly been adopted, nevertheless, its provisions in the main have been complied with under appropriate orders of the court.

We are therefore still willing to acquiesce in the plan as a vehicle of prompt reorganization at this time.

We are also willing that a postponement of six months, as requested by the Debtor, should be granted; not be-
5227 cause we acquiesce in all of the several propositions stated by Messrs. Dick, Colpitts and Davis, for we do not, but rather, so that the results of this period both as to traffic movement and expenses, which are now unusually uncertain, may actually be known when consideration is given to this plan.

We are not agreeable to changes in this plan which will affect the priorities of the mortgage liens as to either principal or interest, and we would contest any proposal which would modify or diminish the rights of creditors to the benefit of stockholders, or which would dispossess us of any of our contractual rights and still retain the existing stock interests in the reorganized corporation.

Such, we believe, would not conform to the requirements of Section 77 of the Bankruptcy Act.

We do not understand that those representing the Debtor propose any such modification, and that the plan as previously proposed is not withdrawn or modified.

With this understanding we interpose no objection to the suggested adjournment.

We would further like at this time to have the record show that in the opinion of our committee, whose chairman has made a personal inspection of the Debtor's line, the operation of the property by the trustees under the direction of the court has been such as adequately to
5228 protect the public interest, and that during the trusteeship the physical condition of the property has been improved.

The ability of the trustees to pay interest in accordance with the terms of the plan now on file and with the approval of the court has helped materially in preserving the credit of the enterprise as shown by the road at which the trustees have been able to borrow money for equipment purchases.

Unless there is any question that you gentlemen have, that is all the statement that we would like to make at this time.

Commissioner Porter: Well, I don't know that I understand your position. Do I understand, in the first place, that you do affirmatively now, at this time, ask some time on your own behalf to examine the data that has been introduced here today and to have opportunity to rebut it, or anything of that kind? Do I understand that is one of the things included in your statement?

Mr. Burgess: That is one of the things included in my statement.

Commissioner Porter: How long would that take? I am laying aside now the other request, or your acquiescence in the six months proposition; I am simply asking you if I understand you correctly, in reading 5229 the statement that you just read, to make a request that some time be given you, and I would like to ask how much that would be, for you to prepare, or, rather, I would say, first, to study this data and meet it in any way that you see fit, of course, or not, as you see fit.

Mr. Burgess: Well, on the assumption that I have stated, that is, that this plan that was filed with the Commission, is neither modified, nor sought to be withdrawn by the Debtor; my whole statement proceeds upon that assumption.

Mr. Swaine: That is a correct assumption.

Mr. Burgess: And that is correct, Mr. Swaine. Then I should say that so far as an examination of this data is concerned and the submission of any evidence that we should like to make in connection with it, we could accommodate ourselves so as to do that at a hearing early in the fall, for example.

Commissioner Porter: Oh, well, you ought not to require any such length of time as that. Frankly, Mr. Burgess, I just can't see my way clear to grant anything of that kind, so, frankly, you better make it within some brief period, if you want it granted for that purpose, because I can't, under the guise of your request, acquiesce in the six months request.

Mr. Burgess: Well, I am not asking for any addi-
5230 tional time over and above the six months.

Commissioner Porter: Well, I am saying, leaving that out. My question to you is that laying entirely to one side the six months request, I understood your statement to say now that in the light of what has occurred here today, you needed and desired some time to examine the data and to offer evidence, or not, as you see fit, after an examination of what has been offered here today.

Mr. Burgess: So far as that is concerned, we would accommodate ourselves to whatever engagements the Commission might have and might make.

In the North Western Case, that case, as I recall it, was adjourned until the middle of September, and that is what I had in mind when I said early in the fall, but I have no particular time to request for that. We will accommodate ourselves to whatever the Commission finds convenient and desirable. We also acquiesce in the other request that was made.

Commissioner Porter: Yes; I understood that.

Is there anything else anyone has to present at this time?

There is before us, as I understand it, the request of the Director General of Railroads asking leave to inter-
5231 vene. I understand this has been now given to counsel. Has anyone any objection to it? In the absence of any objection, the intervention of the Director General of Railroads will be permitted.

Of course, gentlemen, I think you all understand that it has been the desire of Division IV, that has charge of these cases, for administrative purposes, that the record in these various cases, including the case that he have had here on hearing today—that the record be closed at the earliest possible date. I think everybody understands that, and, of course, I am confronted with that today in passing on this matter, with that known attitude of the Division, in conference on these various cases.

I am quite sure that the Division would be adverse to continuing this case for six months or any longer period than that for the purpose of trying to see what may happen in the future. I am inclined to think that possibly in this time—except, of course, as my rulings are at all times subject to review by the Commission, if any party cares to appear,—that I will continue this hearing until the 15th day of September. That is practically 90 days.

And, may I say that it will be the desire of the Commission to close this record at that hearing. Now, should anyone in the meantime and before that date feel
5232 that a longer time than that is required before this record should be closed, I am going to suggest now that they place that in writing and address it to the Division so that the Division will be in a position to pass on it at that time, if such application is made, because in the absence of such application I think it would be my purpose, and would be my intention, as the presiding Commissioner, to close the record at that time.

I throw that out so that all the parties will understand that.

Mr. Burgess: I was going to direct your attention to the fact that the North Western case is set for the 14th of September, and I rather imagine that that hearing will last for some days.

Commissioner Porter: Well, that is before another Examiner.

Mr. Burgess: Well, it happens that Mr. Walker and I are representing fiduciary interests in that case as well.

Mr. Swaine: I am in that case also.

Commissioner Porter: Off the record.

(Discussion off the record.)

Commissioner Porter: So that, let the record show that with the suggestions I have heretofore made that this hearing is adjourned until 10 o'clock a. m. on the 20th day of September of this year.

(Adjournment to September 20, 1957, 10:00 a. m.)

3707 INTERSTATE COMMERCE COMMISSION.

Washington.

Offices of
Claude R. Porter,
Commissioner.

August 12, 1937.

To the Parties of Record, Proceedings for Reorganization Chicago, Milwaukee, St. Paul and Pacific Railroad Company, F. D. 10882, before the Interstate Commerce Commission.

Gentlemen:

You will recall that at the close of the hearing in this proceeding held on June 16, 1937, I stated that it will be the desire of the Commission to close this record at the next hearing, which is to be held on September 20, 1937, and "should anyone in the meantime and before that date, feel that a longer time than that is required before this record should be closed," I suggested that "they place that in writing and address it to the Division, so that the Division will be in a position to pass on it at that time", stating that in the absence of such application, "it would be my intention as the presiding Commissioner, to close the record at that time".

In the absence of a petition directed to Division 4 and any ruling to the contrary, it is still my desire to close this hearing at the forthcoming session. With that in view, all parties should be prepared to offer all the additional evidence which they desire to present and to supply to the counsel a reasonable time prior to the hearing with copies of exhibits which they expect to offer.

Very truly yours,
(Signed) Claude R. Porter,
Commissioner.

3720 ORDER.

At a Session of the Interstate Commerce Commission, Division 4, held at its office in Washington, D. C., on the 15th day of September, A. D. 1937.

* * (Caption—10882) * *

Upon further consideration of the record in the above-entitled proceeding and of the petition filed September 13, 1937, by the Chicago, Milwaukee, St. Paul and Pacific Railroad Company, debtor, by its president, requesting an adjournment of the further hearing assigned before this Commission on September 20, 1937;

It Is Ordered, That said petition be, and it is hereby denied.

By the Commission, division 4.

W. P. Bartel,
(Seal) *Secretary.*

BEFORE THE INTERSTATE COMMERCE COMMISSION.

* * (Caption—10882) * *

Hearing Room, I. C. C. Building,
Washington, D. C.,
Monday, September 20, 1937.

The above-entitled matter came on for hearing at ten o'clock a. m., pursuant to adjournment.

Before:

Commissioner Claude R. Porter,
Director O. E. Sweet, and
Examiner M. S. Jameson.

Appearances:

Robert T. Swaine of Cravath, deGersdorff, Swaine & Wood, 15 Broad Street, New York City, New York, appearing for Debtor.

Kenneth F. Burgess, 11 South LaSalle Street, Chicago, Illinois, appearing for Group of Institutional Investors and Fiduciaries.

Messrs. Harry Hoffman, Theodore E. Rein and Milton E. Mermelstein, 30 Pine Street, New York City, New York, appearing for Anglo-Continentale Treuhand, A. G., holder of Milwaukee & Northern Railroad bonds.

George L. Shearer, for Stewart & Shearer, 45 Wall Street, New York City, New York, appearing for United States Trust Company of New York as trustee of the General Mortgage of the Chicago, Milwaukee & St. Paul Railway Company, due May 1, 1989.

Meyer Abrams, 134 North LaSalle Street, Chicago, Illinois, appearing for Israel Abrams, Sol Abrams, Henriatta Chatiner and Charles Rosenbloom.

Thomas F. Murphy, 41 Broad Street, New York City, New York, appearing for Imperial Trust Company, Ltd., 327 Bay Street, Island of New Providence, Bahamas.

Henry T. Hunt, Interior Department Building, Washington, D. C., appearing for Federal Emergency Administration, Public Works, Harold L. Ickes.

Edwin S. S. Sunderland, of Davis, Polk, Wardell, Gardiner & Reed, 15 Broad Street, New York City, New York, appearing for Guaranty Trust Company of New York and Merrel P. Callaway, as trustees of the Fifty Year 5% Mortgage, dated as of February 2, 1925, of Chicago, Milwaukee, St. Paul & Pacific Railroad Company.

Mrs. Alice Cunningham Lacey, 73 Elm Street, Jamaica Plain, Massachusetts, appearing for William G. Cunningham, 73 Elm Street, Jamaica Plain, Massachusetts.

Jack E. Bagon, 475 Fifth Avenue, New York, N. Y., appearing for Imperial Trust Company, Ltd.

J. T. Haslam, United States Treasury, Washington, D. C., appearing for Director General of Railroads.

C. Francis Murphy, Department of Justice, Washington, D. C., appearing for Director General of Railroads.

Joe D. Hughes, United States Treasury, Washington, D. C., appearing for Director General of Railroads.

Russell L. Snodgrass, Assistant General Counsel, 1825 H. Street, N. W., Washington, D. C., appearing for Reconstruction Finance Corporation.

Thomas S. McPheeters, Jr., 314 N. Broadway, St. Louis, Mo., appearing for St. Louis Union Trust Company and Illinois State Trust Company, Trustees of Chicago, Milwaukee & Gary Railway Mortgage Deed of Trust.

Edward E. Watts, Jr., 20 Exchange Place, New York, N. Y., appearing for City Bank Farmers Trust Company, as Trustee under the Milwaukee & Northern First Mortgage and as Trustee under the Milwaukee & Northern Consolidated Mortgage.

O. W. Dynes, 888 Union Station Building, appearing for Trustees of Chicago, Milwaukee, St. Paul & Pacific Railroad Company.

D. Willard, Jr., 805 Transportation Building, Washington, D. C., appearing for the Railroad Credit Corporation.

Robert M. Becket, of Wright, Gordon, Zachary & Parlin, 63 Wall St., New York, appearing for Chemical Bank & Trust Company, Trustee under the First and Refunding Mortgage.

Julius Weiss, 551 Fifth Avenue, New York, N. Y., appearing for Independent Bondholders Committee, an intervener.

Thomas O'G. Fitzgibbon, 15 Broad Street, New York City, appearing for Guaranty Trust Company of New York and Muriel Callaway, as Trustees of the 50-Year Mortgage.

Proceedings.

Commissioner Porter: The hearing is called to order.

Mr. Becket: If your Honor please, my name is Robert M. Becket of Wright, Gordon, Zachery & Parlin, 63 Wall Street, New York City. We represent the Chemical Bank & Trust Company as trustee of the First and Refunding Mortgage, and I have a petition for leave to intervene that I would like to present.

I have copies for distribution to the others.

Commissioner Porter: Is there any objection on the part of anybody this morning? I hear none. The petition will be received then and filed. You have copies to distribute to counsel and the people who are present?

Mr. Becket: Yes, sir.

Mr. Swaine: Mr. Commissioner, Mr. Willard, representing the Railroad Credit Corporation, informed me that the marshalling and distributing plan under which the various carriers acted in connection with railroad credit, and which affects the claim with respect to credit of the debtor, has not been introduced in evidence and made a part of the record in this case.

In order to complete the record in that respect, I would like to offer the marshalling and distributing plan of the Railroad Credit Corporation in evidence in this case.

Commissioner Porter: Exhibit 154 will be the number. Do I hear any objection? Hearing none, it will be received.

(EXHIBIT NO. 154, Swaine, counsel, received in evidence.)

Mr. Swaine: Mr. Scandrett, will you take the stand?

HENRY A. SCANDRETT was recalled and testified further as follows:

Direct Examination.

Mr. Swaine: Mr. Commissioner, Mr. Scandrett has appeared already several times and has been sworn.

Commissioner Porter: Yes, I so understand. You may proceed.

Q. (By Mr. Swaine.) At the last hearing held in June of this year, Mr. Scandrett, you presented as Exhibit 121 a forecast of earnings for the years 1937 to 1941, inclusive, and, as I remember it, a balance sheet as of the end of the year.

Have you now prepared a balance sheet as of the last available date, July 31, 1937?

A. Yes, sir.

Mr. Swaine: I would like to offer that in evidence.

Commissioner Porter: That will be Exhibit 155.

(EXHIBIT NO. 155, witness Scandrett, received in evidence.)

Q. (By Mr. Swaine.) That also contains, does it not,

an income statement for the seven months ended July 31, 1937?

A. That is correct.

Q. Will you be good enough to explain to the Commission any changes which have occurred in the situation as affecting the income account either on the side of gross revenues or on the side of operating expenses since the last hearing?

A. At the June 16, 1937, hearing I summarized briefly the results of operation for the years 1935 and 1936. I desire to make a similar summary for the seven months ended July 31, 1937. Railway operating revenues were $61,066,523.78, an increase over the same period of 1936 of $1,050,404.09, or 1.8%. Railway operating expenses were $50,167,400.67, an increase of $1,444,624.19, or 3%, which was principally due to additional maintenance of equipment, increase in traffic and less maintenance of way and structures.

Net railway operating income for the seven months ended July 31, 1937, was $4,868,271.23, an increase over the same period of 1936 of $1,819,630.87. The figures for the seven months of 1937 include a credit of $1,523,755, reversing charges included in the year 1936 on account of the 1935 Railroad Retirement Act, later amended to become effective January 1, 1937, and a charge of $856,428 under the amended act, whereas the period ended July 31, 1936, includes a charge of $759,514, which is a part of the $1,523,755 credited in the 1937 period. Eliminating the charge from the 1936 period and the credit from the 1937 period, net railway operating income for the 1937 period was $463,638.13 less than the same period of 1936.

Income available for fixed charges in this period, including the credit adjustment referred to above, was $5,625,810.28. Fixed charges were $8,705,221.44, which left a deficit of $3,079,411.16 before deduction for interest on Convertible Adjustment Mortgage Bonds. Interest on Convertible Adjustment Bonds accrued at 5% was $5,333,816.04, making a deficit for the period of $8,413,227.20.

The net increase in Investment in Road and Equipment during the period was $5,439,208.73. This increase was due to gross additions and betterments to road property of $2,913,232.51 and of equipment, $4,256,419.87, a total of $7,169,652.38, less retirements and conversions of $1,730,443.65.

Funded debt in the hands of the public increased $3,530,365.10. It was increased $5,835,000 by Equipment Trust Certificates, Series "P" and "Q" and reduced by the payment of equipment obligations of $2,014,634.90 and by the payment of one serial collateral note (former P. W. A. loan) to the Reconstruction Finance Corporation, amount $290,000.

Equipment Trust Certificates, Series "P", principal amount $3,180,000, were sold at 102.55 plus per cent of par. They bear interest at the rate of 3½ per cent and will mature serially beginning January 1, 1938, in fifteen annual installments of $212,000 each. Part of the proceeds from the sale of these certificates was applied to the purchase of one "Hiawatha" type locomotive and the balance will be applied to the purchase of 30 new freight locomotives.

Equipment Trust Certificates, Series "Q", $2,655,000, were sold at 100.067 plus per cent of par. These certificates bear interest at the rate of 3¼ per cent and will mature serially beginning March 1, 1938, in fifteen annual installments of $177,000 each. The proceeds from the sale of these certificates are being applied to the cost of constructing in the shops at Milwaukee by the Trustees as Builders, 33 passenger train cars, 500 hopper coal cars and 500 automobile cars. As of July 31, 1937, 23 passenger cars and 250 hopper coal cars had been delivered to the railroad.

During the seven months period The Railroad Credit Corporation credited on our note of June 27, 1934, $103,856.96, the Company's share of distributions under the Marshalling and Distributing Plan, making the balance due on this note as of July 31, 1937, $458,688.52. On the note dated May 29, 1933, payments were made during the period by the Milwaukee Land Company in the amount of $700,000, making the balance due as of July 31, 1937, $220,000. The amount due The Railroad Credit Corporation as of July 31, 1937, on these two notes was $678,688.52. The balance of advances by the Company to The Railroad Credit Corporation, subject to distribution in accordance with the Marshalling and Distributing Plan, 1931, as of July 31, 1937, was $560,827.53.

There has been handed to me this morning a statement by Mr. Willard, General Counsel for the Railroad Credit Corporation, which shows the status of that account as of September 18, 1937.

As of that date the principal due and unpaid was $587,145.74.

The undistributed book balance of our distributive share under the Marshalling and Distributing Plan was $519,284.75, and the income accrued on fund contribution was $90,189.63, making a total of $609,474.38.

That credit item, it will be observed, is but $22,000 in excess of the balance due from the company on its note. As to how much of that undistributed balance will ultimately be available, I do not know.

Q. Mr. Scandrett, in the light of today's conditions, have you participated with the Board as to the determination of what should be done about a plan of reorganization?

A. Well, I have, Mr. Swaine, but I think I would prefer, if it suits your convenience, to put in a statement that has been prepared on the forecast of earnings and cash.

Q. I want to get that. What is your present forecast of earnings and cash for this year?

A. At the hearing on June 16th I submitted an exhibit, No. 121, showing estimated results of operation under the proposed plan of reorganization of July 1, 1935, for the five years 1937 to 1941, inclusive. We have not revised the estimates in this Exhibit for the years 1938, 1939, 1940 and 1941 to allow for the increases in labor and material costs since June because we do not yet know the outcome of the demands of the train service organizations for increase in wages, the full effect of the Guffey Coal Bill on the cost of fuel, nor the offsetting possibilities in rate increases. We feel the net effect of all these things will tend to reduce our net income in the future. We have restudied the estimate for 1937 and believe the actual results will roughly approximate the results as we estimated them last June. Since then freight revenues have been disappointing, running for each of the months, June, July and August about half a million under the corresponding months of last year. We have, however, had fairly good crops in our territory and are anticipating increases in revenues over last year in the last three months of this year. There is a present tendency of the farmers to hold their grain for better prices and this, together with an apparent general slowing down in industrial activities, may reduce revenues for the balance of the year below present estimates.

Our most recent estimate of income for this year compares with the estimate for 1937 given in Exhibit No. 121, as follows:

Freight revenues are slightly less but total operating revenues are about the same ($112,800,000).

Operating expenses are increased about $600,000 (from $88,085,000 to $88,675,000), with a corresponding increase in operating ratio. The increase of 5 cents per hour to non-operating crafts, effective August 1, would have increased our expenses this year about $1,300,000 but the effect has been partly offset by reduced work programs and reductions in other forces. On an annual basis the increase in wages will increase our expenses about $3,000,000. No allowance has been made in our estimates for increase in wages to the operating crafts who are demanding a 20 per cent increase.

Taxes are reduced about $1,600,000 due mainly to a credit of $1,523,755 in this year's accounts reversing charges made in 1936 under the Railroad Retirement Act, which has been amended to be effective January 1st this year. Income available for Fixed Charges is increased about $1,300,000, from $12,043,000 to $13,350,000. Without the tax credit we would now estimate this income about two hundred thousand dollars less than the estimate in Exhibit No. 121.

Cash on hand at the end of this year without providing for any payment of General Mortgage interest and without any allowance for increased wages to train and engine men, is now estimated at $10,900,000. Annual income and cash at the end of this year are, of course, greatly dependent upon revenues. For every million dollars loss from our estimate of revenues, both annual income and cash on hand at the end of the year would be reduced by about $750,000. They would also be reduced by any increase in wages granted to train and engine men, particularly if made retroactive. The foregoing estimate of cash to be on hand the end of the year is $550,000 in excess of the corresponding figure of $10,350,000 estimated to be on hand at the end of 1937 in Exhibit No. 121. That exhibit contemplated payment of $3,968,000 of fixed General Mortgage interest and $4,500,000 of Contingent General Mortgage interest, a total of $8,468,000. On the other hand the exhibit contemplated the borrowing of $8,000,000 as a reorganization loan. On a comparable basis therefore the two estimates are very close to each other.

Q. Now, did the Board have your report of those facts in determining what its attitude would be at this hearing?

A. Yes, sir.

Q. I believe it is already a part of the record in this case that an application was filed for an indefinite adjourn-

ment of the hearing, and that that application has been denied.

In the light of that action, will you please state to the Commission your present attitude of the debtor toward the problem?

A. As the Commission knows, the Board of Directors of the debtor company has felt very strongly no plan of reorganization should be adopted at this time. The reasons for that belief were placed in the record at the June hearing.

Since the June hearing, and in the light of expressions by you, Mr. Commissioner, at the conclusion of that hearing, the subject was again considered very carefully by the Special Committee of the Board, and by the Board itself. As a result of that consideration a petition was filed with the Commission on September 10th in which we asked that the hearing set for today be adjourned.

That petition embodied much of what has been submitted at the June hearing, and in addition the effect of the wage increases which became effective August 1st, and also referred to additional wage demands now pending undetermined, as well as other increased costs of operation. On Thursday of last week we received advice our petition had been denied and that the hearing would proceed on September 20th.

I have no disposition to reargue the question of postponing the reorganization of this property until we can better appraise than anyone can do now what can be expected in the future from an earnings standpoint. I accept this decision of this Division of the Commission as being its definitive notice to us that notwithstanding the uncertainties of the situation it is its considered opinion that plans of reorganization should go forward without delay.

In the brief interval since this decision the Board of Directors as a Board has not had an opportunity to consider the situation in the light of that decision. The statute requires the debtor to submit a plan of reorganization. We have complied with that requirement, but we have said to the Commission that if the property must be reorganized at this time we do not believe this plan will fit the situation.

The Special Committee of the Board has taken steps to institute negotiations with the Committee of Security Hold-

ers of which Mr. Frederick W. Walker is Chairman, to see if we can agree with that Committee on modifications of the present plan or on a new plan. It also intends to discuss the situation with the Committee of Preferred Stockholders, if the Commission shall approve the application of that Committee now pending before it.

If we are unable to reach an agreement with either or both of these Committees, my recommendation to the Board will be that the debtor itself make a further attempt to work out a new or modified plan.

No man can say what time would be required to reach an agreement or to find agreement is impossible. I can and do assure the Commission that the discussion and negotiations will be pursued with all diligence. I would hope that conclusions could be reached within 120 days, and I ask for a postponement of that period.

Mr. Swaine: That is all for this witness.

Mr. Burgess: May it be understood, Mr. Swaine, that this petition that was filed, to which Mr. Scandrett referred, that was dated September 9, 1937, asking for a postponement, shall be a part of the record?

Mr. Swaine: I assume it is a part of the record.

Commissioner Porter: Yes.

Mr. Burgess: Now then, it is to be considered a part of the record. Then, may I ask Mr. Scandrett: You signed this petition, did you not?

The Witness: I did.

Mr. Burgess: Are the facts therein stated true and correct to the best of your knowledge and belief?

The Witness: They are.

Mr. Burgess: That is all.

Mr. Abrams: May I ask a couple of questions?

Mr. Swaine: Just a moment. To keep the record straight, will counsel state his name?

Mr. Abrams: Meyer Abrams, of Chicago.

Mr. Swaine: You have intervened?

Mr. Abrams: Yes.

Cross-Examination.

Q. (By Mr. Abrams.) You were here as a witness in August, 1935, when the first plan was presented, weren't you?

A. Yes, sir.

Q. You then testified that the plan was fair, equitable and feasible?

A. Well, no; I did not use those words. I testified that we felt that this plan was fair as between the different security holders, including the stockholders. I did not say it was feasible. I said that we hoped that if the property could be promptly reorganized under that plan, and with the increase in traffic that we hoped and expected to get, that the plan would work.

Q. The question was then asked whether the present revenues of the railroad would in any way tend to show the income for the respective future years. And, do you remember whether you stated that its present income in 1935 was not to be considered?

A. No; I do not remember that. The figures that were put in as to earnings and expenses in future years were put in by Mr. Sparrow, our chief financial and accounting officer.

Q. You yourself don't know anything about the figures, do you?

A. No; I think I know quite a bit about them.

Q. Well, you didn't put in any of the figures the last time, did you?

A. What do you mean by "the last time"?

Q. The revenues and expenses and the basis upon which the former plan was prepared.

A. I put in all the figures at the last hearing, preceding this one.

Q. I mean, in August, of 1935.

A. Well, I put in a good deal of testimony in August, 1935, but what I said to you was that the figures indicating the results under certain assumed revenues were put in evidence by Mr. Sparrow. Of course, I had gone over the matter with him very fully and very carefully before we had that hearing. I was very familiar with the figures.

Q. Your original plan that was filed in this case as amended was predicated upon a speculative revenue and operating expenses, wasn't that right?

A. No, I would not say that.

Q. It was not?

A. No.

Q. And is it now your idea that you cannot put through the plan because you cannot tell what the revenues and operating expenses will be in the next three or four years? Is that why you can't put through the plan?

A. Well, our position with reference to that is that there are so many added burdens on the railroads since

that date, and so many present uncertainties with reference to expenses, that it is the part of Wisdom, and in the interest of fair dealings with all interests, to postpone the promulgation of a final plan of reorganization until some of these uncertainties are solved.

Q. How long a time do you think it would take to settle these uncertainties?

A. Well, I think a good many of them will be clarified within the next 90 or 120 days. Of course, we always will have uncertainties, Mr. Abrams, but these are unusual.

Q. Those are uncertainties that will remain forever, I suppose?

A. Some uncertainties, I think, will always be in the situation.

Q. So, a delay of three of four months is not going to solve the problem of the reorganization?

A. There will be uncertainties at the end of three years or two years or thirty or forty years.

Q. Well, then, do you expect to keep all these reorganizations up until all of these uncertainties will be solved?

A. No; I do not.

Q. What uncertainties do you expect will be solved within the next three months if you get a continuance?

A. Well, the question of the wages that we will have to pay in the future to our train and enginemen will, I think, very certainly be settled within that period. I would hope that we might be on the way to solving the uncertainties as to what our rate level will be.

Q. Suppose you put through your reorganization three or four months from now, and a wage schedule has been ascertained, and suppose a year from now the rate scale would be different, would you have to go through another reorganization?

A. No. I assume that the reorganization plan would be sufficiently conservative to take care of changes in the future, with the possible exception of cataclysmic changes.

Q. Did you consider the plan as originally filed and amended sufficient to cover all the items enumerated therein, were it not for the changes that took place since then?

A. I don't think I understand your question.

Q. I will repeat it. Did you consider under the plan as you originally filed and amended it, that were it not for the changes that took place since June of 1937, that you

would have sufficient available income to cover all the items of interest and fixed charges under your plan?

A. Well, now, you ask me whether I did consider in 1935 that the plan would be effective except as to changes which took place in 1937? Now, I didn't know anything about 1937 in 1935.

Q. I am asking whether at that time you considered that the railroad income would be sufficient?

A. We considered that if the earnings that we assumed were realized, and that with those earnings we were able to hold our expenses at the figure we were confident we could hold them under those conditions then existing, that the plan had a very good chance of working out.

Q. You will now admit that the plan as submitted is not feasible?

A. Well, as to the position that we have taken before the Commission, I don't know that it is profitable for you and I to discuss it, because the Commission has disagreed with us. We have taken the position that we think the reorganization should be postponed until some of these doubts are cleared up.

Q. I am not asking about postponement at all. I am asking whether you now admit that the plan that was proposed by the debtor is not feasible?

A. No, I do not admit that. It is conceivable that this plan well might work out.

Q. Have you considered any changes or modifications?

A. Oh, yes.

Q. Have you taken that up at a meeting of the Board?

A. Yes; and we have discussed it.

Q. What changes have you considered?

A. Well, I don't know that it would be pertinent for us to go into that with you, Mr. Abrams.

Mr. Swaine: I think the negotiations or modifications will not be helped by a discussion here of what those modifications might be.

Mr. Abrams: I think we are entitled to know what effort the debtor has made towards bringing about a final, definite reorganization plan, and to know what steps they have taken to cure the evils in the present plan, and we are entitled to go in and find out what they said at the Board for that purpose.

A. There are no evils in the present plan, so far as we are advised.

Mr. Abrams: Well, I have asked the question and there is an objection. What is the ruling on it?

Commissioner Porter: Objection sustained.

Q. (By Mr. Abrams.) Is there any specific body that has undertaken to revise the plan and submit it?

A. Well, there has been no revised plan submitted.

Q. Does the debtor intend to submit the revised plan?

A. Well, I made the statement to the Commission a few moments ago that we had instituted negotiations with the Committee of Security Holders, and it would be our purpose to pursue those energetically.

Q. But you haven't anything definite in mind yet?

A. We have not anything definite to say to you at this time.

Q. Have you got anything definite to say to the Commission?

A. I think I have been reasonably definite with the Commission.

Mr. Abrams: That is all.

Mr. Weiss: My name is Julius Weiss, representing the Independent Bondholders Committee.

Mr. Swaine: You say you are Mr. Julius Weiss, representing the Independent Committee?

Mr. Weiss: The Independent Bondholders Committee.

Mr. Swaine: Of what?

Mr. Weiss: I am an intervener in the proceedings.

Mr. Swaine: Have you formally intervened?

Mr. Weiss: Yes.

Mr. Swaine: You are a committee qualified under Section 77?

Mr. Weiss: And an order has been issued by the Commission permitting us to intervene. It is a part of the record in these proceedings.

Mr. Swaine: Well, I would like to point out that this is a protective committee seeking to act under Section 77, and, as far as I know, it has never qualified under Section 77.

Director Sweet: When was your Committee formed, Mr. Weiss?

Mr. Weiss: We were formed before the amendment to Section 77, to which Mr. Swaine refers, and an order was issued by this Commission permitting us to intervene in December or November, 1935.

Director Sweet: You contend, under those conditions, it is necessary to get anything additional?

Mr. Swaine: If that is the fact. I am not sure it is. I will check up.

Commissioner Porter: Proceed.

Q. (By Mr. Weiss.) The preparation of any plan does require the exercise of some prophetic faculties, doesn't it, Mr. Scandrett?

A. Well, I don't know as to the prophetic faculties.

Q. In the last analysis, any plan depends on the good judgment of its framers, doesn't it?

A. Well, I think judgment is an important element in it.

Q. And that judgment involves the consideration of the past and the present and then some judgment as to what the future will bring, in the light of that?

A. Well, that is a part of it, I think.

Mr. Weiss: That is all.

Mr. Bagon: My name is Jack Bagon.

Mr. Swaine: Whom do you represent?

Mr. Bagon: The Imperial Trust Company, Francis Keller, and John Roth.

Mr. Swaine: What do they hold?

Mr. Bagon: Milwaukee & Northern unextended consolidated bonds, June 1, 1934, before the proceedings were instituted.

Commissioner Porter: Proceed.

Q. (By Mr. Bagon.) You said Mr. Walker was Chairman of the Security Holders Committee?

A. Of a committee of security holders.

Q. Can you tell me what securities they represent?

A. I cannot. I think they represent, I believe, some $85,000,000 of securities; I think of all of the securities that are outstanding.

Mr. Swaine: Just to correct that: You don't mean all of the securities or bonds. They do not represent any stock?

A. No stock. I think they or their representatives hold all of our bonds, including bonds of subsidiary companies.

Q. (By Mr. Bagon.) Do they represent Milwaukee & Northern unextended consolidated mortgage bonds due June 1, 1934?

A. I don't know anything about that.

Q. There are $234,000 presently outstanding?

A. I don't know what their holdings are.

Q. Well, do you know whether the Committee has made arrangements to confer with the outstanding principal amount of Milwaukee & Northern unextended and consolidated mortgage bonds due June 1, 1931?

A. No, I don't know anything about that.

Mr. Bagon: That is all.

Commissioner Porter: Any further cross-examination of Mr. Scandrett by anybody?

Examiner Jameson: Mr. Scandrett, in connection with the amount of direct unsecured obligations, do you care to make a general statement explaining the change in the amount of those obligations between June 30, 1935, and May 15, 1937?

A. Well, I haven't that in mind, but we have our Comptroller here who can give you any information on that that you desire.

Examiner Jameson: Well, in round numbers the amount in 1935 was $20,284,000 of direct unsecured obligations, and it appears in May that that had been reduced to something like four and a half million. I thought it would be well to have a general explanation of that change and how it occurred.

Mr. Swaine: That figure was the amount, or represented the amount claimed at the original date. In the intervening period a great many claims which had been made for a large amount were liquidated. That explains a very large part of the reduction. Also I am advised that there were pay-roll items in that first amount that were cleaned up by the time the second amount was stated.

The Witness: We can file a statement with reference to that, if you desire.

Examiner Jameson: I think probably that will finish it. I notice the amount of claims not entitled to priority changed very materially. I suppose there is some such explanation that would apply to that also?

Mr. Swaine: That is right.

Examiner Jameson: There was an increase from half a million to over four and a half million in that class of claims.

Commissioner Porter: Mr. Scandrett, just to understand how definite or indefinite your assurances are as to whether the debtor or anybody will come forward with an amended or new or changed plan, I wish you would just simplify that a little, in general, say; I don't mean in detail, but how far have you gone, and what assurance will the Commission have that if this hearing is not closed, say, today, that there will be before us here for consideration a different or amended or some other plan, with this present one changed, if it is continued—if you understand just what I have in mind.

The Witness: Well, I think I do, Mr. Commissioner. Of course, we had anticipated that the Commission's ruling was to be the opposite of what it was. Now, we have had very little time since then to do anything. At about the time we filed our petition, we took up with the Committee, of which Mr. Walker is Chairman, the question as to whether they would be willing to enter upon a discussion with us as to modifications of the plan, and were promptly advised by the Committee that they would do so.

Now, if this postponement is granted, why that is going to be the first order of business, and it is going to be pursued diligently and it is going to be pursued on our part with the purpose of reaching an agreement, and I have no doubt that that would be the viewpoint from which the Walker Committee would approach it.

Now, I could not be placed in the position of saying to the Commission that within 120 days we will be in here with a plan approved by these two interests, nor could I say to the Commission that within 120 days, if we reach an impasse with the Walker Committee, that we will have a modified plan for submission to you.

A great many things are to be considered. It is a terrific problem, and all I can say and I do say that with all earnestness and emphasis, is that we will do our very best to carry forward that undertaking. It is something that we have said we didn't think should be undertaken at this time. Now, your Division has disagreed with us, and so we are proposing to go forward under your interpretation of the law and what you think the situation requires. I don't think I could be any more definite than that.

Commissioner Porter: That is all, unless somebody else has a question.

Mr. Swaine: Mr. Dick.

FAIRMAN R. DICK was recalled and testified further as follows:

Direct Examination.

Q. (By Mr. Swaine.) Mr. Dick, you are a member of the board of directors of the debtor?

A. Yes.

Q. And of the special committee appointed by the Board to deal with the reorganization problems?

A. Yes, sir.

Q. And have been acting as Chairman of that committee?

A. Yes.

Q. Will you please state to the Commission the approach which that committee has had to the problem to which the debtor has been addressing itself since the last hearing?

A. During the last month, the Special Committee of the Board to deal with reorganization problems has reconsidered the question: what, if any, modifications of the 1935 Plan may properly and intelligently be suggested by the Debtor at this time? The risks of the 1935 Plan in respect of the two points mentioned during the June, 1937, hearing have been increased rather than diminished since that hearing.

Q. What are those two points?

A. The two points were the failure to provide an adequate medium for new financing and the risk in regard to the accumulation of interest on the adjustment bonds proposed in the plan.

Q. To be delivered in exchange for the 50-year bonds?

A. That is correct.

The Committee was unanimously of the view, and that view was unanimously concurred in by the full Board, that no Plan of reorganization of this property can be predicated upon today's earnings without doing such violence to all classes of the Debtor's securities, from the General Mortgage bonds down to the stock, as to indicate a degree of hopelessness as to the railroad situation which would, apart from its effect on private rights, disastrously affect railroad credit.

Any such Plan would, it is believed, ultimately prove to have been grossly unfair to all classes of the Debtor's security holders, for neither the Special Committee nor the full Board can believe that the Commission expects that the railroads shall bear the increasing burdens which have recently been imposed upon them, without being provided in some manner by compensating revenues.

On the other hand, it would be both rash and unintelligent to attempt to predicate a Plan at this time upon that belief, for firm as its belief is, the Special Committee has had no assurance that such additional revenues will be provided, or if so, to what degree.

Until the answer to this problem is given, or at least

indicated, any Plan of reorganization for the Debtor will either be purely guesswork or violent destruction of security values. For these reasons, the Board of Directors directed the filing of the application for an adjournment of this proceeding, which the Commission has denied.

Meantime, the Special Committee has requested the Chairman of the Institutional Bondholders' Committee to meet with it to discuss modifications to meet the two particular problems which have heretofore been indicated. The Chairman of the Bondholders' Committee has stated the willingness of that Committee to enter into such conferences with the Special Committee of the Board, and it is hoped that they can promptly be arranged.

I would be lacking in candor if I did not state to the Commission here that if reorganization is to be forced at this time, the effect upon the General Mortgage Bonds of any solution of the first problem which will even have a superficial appearance of being satisfactory will be so drastic that the Debtor's Board is unwilling even to suggest it. On any such hypothesis the problem is the problem of the bondholders and not of the Debtor's stockholders, and the Special Committee believes that any suggestion as to its solution must come from the bondholders themselves as the parties most immediately concerned.

Furthermore, I would also be lacking in candor if I did not state here that from my own study of the situation I am convinced that a reorganization at this time sufficiently drastic to create even a superficial appearance of restoration of the Debtor's credit will, in fact, destroy rather than restore railroad credit.

Reorganization of a railroad is undertaken to lift the bankruptcy and restore its credit. The purpose of restoring credit is to assure the maintenance of an adequate transportation system. This was never more clearly stated than by the Commission in the O'Fallon case decision as follows:

"The end in view, as we have stated, is the maintenance of an adequate national railway transportation system. Such a system, so long as it is privately owned, obviously cannot be provided and maintained without a continuous inflow of capital. Obviously, also, such an inflow of capital can only be assured by treatment of capital already invested which will invite and encourage further investment."

A continuous inflow of new capital can only be obtained,

in the last analysis, by a level of earnings which will attract capital. This does not mean that earnings must be adequate every year. Earning power always varies between periods of prosperity and periods of depression, but to the extent that earnings during depression fall below the required level, then to this extent they must be made up during the following period of prosperity.

The greater the deficiency during depressions the greater must be the earning power during prosperity, and where earnings are highly volatile, the sum total must be greater than where earning power is more stable. This is for the reason that if continuity of income return is jeopardized, the expectation of total return must be greater. If, for example, the Milwaukee cannot service its present general mortgage during depressions, then it is obvious that if the investor is to be induced to purchase additional bonds of this mortgage in the future, a materially higher coupon will be necessary. The same principle follows through the balance of the capital structure. On the assumption that present earning power would be a characteristic of all future depressions, satisfactory sales of junior securities would necessitate a fantastic level of earnings during periods of prosperity.

Similarly, adequate earnings are the only foundation for such treatment of capital already invested as will invite and encourage further investment. It may sometimes be possible to obtain a new supply of capital under adverse conditions by scaling or displacing existing debt to the point at which new capital appears to have adequate security through its lien on both the old plant and the new additions. Unless earnings are adequate, however, such a device has but a limited application and cannot assure a railroad of a continuous inflow of capital. Of course, if earnings are adequate no such device is needed. The reason that such a device will not work in the face of inadequate earnings, except on a limited scale and for a limited time, is that with inadequate earnings the time gradually grows nearer when the combination of both old and new capital will fail to develop earnings sufficient to pay interest even on the new capital.

This process is vividly illustrated by the history of the Western Pacific Railroad which is now unable to pay interest on the bonds sold to provide money for improvements since 1916, in spite of the fact that the $60,000,000 in improvements from the sale of those bonds was supple-

mented by $100,000,000 in property previously provided, for which, under the 1916 Reorganization, no fixed interest securities were issued. When, under an inadequate level of earnings, the point is reached where the earnings on both new and old capital are insufficient to pay interest on the bonds sold to provide new money, another receivership becomes necessary and the so-called new capital must be relegated to the old capital position and, in turn, subordinated to bonds to be sold in the future for additional improvements. This is precisely what has happened in the case of the Western Pacific.

Even before the point is actually reached where earnings are insufficient to pay interest, a continuous flow of new capital cannot be obtained by an increase in the debt ratio because when the debt ratio is continually increasing a time arrives when it is impossible to effect further sales of bonds. Then another scaling is necessary so as to bring about a condition where debt ratio can again be increased. During such periods of capital readjustment, the flow of new money necessarily must cease and the supply of money for improvements cannot be continuous.

The truth of this principle and the accuracy of this logic would seem so obvious as not to be subject to challenge, and the conclusion, therefore, would seem to be that a sound reorganization plan, not only for the Milwaukee, but for any railroad, cannot be based on such methods for assuring a continuous flow of new capital. The basic fallacy underlying many of the present proposals to restore railroad credit would seem to be a failure to fully appreciate that a continuous flow of new capital requires adequate earnings, and no sound methods for obtaining new capital can be based on an assumption that earnings in the long run will be inadequate.

The cynical suggestion is sometimes made that if the scaling of present debt is sufficiently radical, if, for example, all debt is translated into stock, at least the day of reckoning will be long postponed. It is unthinkable that such a procedure could have been the purpose of Congress when it enacted Section 77 of the Bankruptcy Act. Even if any such purpose could be attributed to Congress, that purpose would not be effected. It would gradually be realized, and, indeed, it may be realized today, that the pledge of the old investment with the new investment does not, in fact, insure permanent safety since the time in-

evitably approaches when what is called the new capital will be relegated to the position of old capital.

During the period when Jay Gould was juggling capital structures at the expense of investors, many conservative investors would not purchase even the senior securities of any Gould road. The adoption of any policy of confiscating old capital in order to make it possible to raise new capital for similar confiscation in the future would unquestionably lead to the adoption by investors of a similar attitude toward railroad securities in general. It should be further noted that even if such plans actually deceived investors and were followed by satisfactory distribution of bonds sold for improvements, the duration of this temporary and illusory period would undoubtedly be far less than indicated by a computation of the trend of rising fixed charges in relation to net.

This point was clearly demonstrated in the Western Trunk Line territory during the years prior to the present depression. The record in rate cases before the Commission showed gradually mounting debt and a gradual reduction in stock protection. For example, in Exhibit #89 in Rate Structure Investigation, Part II, Ex Parte 87, at Omaha, Nebraska, in January, 1927, it was shown that from 1912 to 1926 bonded debt had increased from $1,514,694,000 to $1,971,289,000 and the stock protection had declined from a market value of $1,231,968,000 to $631,557,000. The extension of the trend lines of this exhibit would have prophesied the era of receiverships as occurring ten to twenty years in the future, whereas, in fact, these receiverships were precipitated by the depression well in advance of the theoretical time. The reason for this is that low and decreasing margins between expenses and revenues render the net exceptionally vulnerable to changes in the volume of traffic brought about by depressions. In this connection it should be pointed out that in 1936 the margin between total expenses and gross revenues of the Milwaukee was 8.7 per cent. As has been previously pointed out, the increased expenses in the immediate future are a substantial percentage of the total present margin.

A study of the record in the Milwaukee case reveals clearly that any basis for reorganization which would assure the Milwaukee of even a limited amount of funds for improvement would do the utmost violence to the present security holders, and obviously would run counter to

the sound principles stated by the Commission in the O'Fallon case quoted above.

There is no intention here to interpret the principle stated in the O'Fallon case as one insuring all security holders against losses. On the contrary, while it is a fact that the common stock of the Milwaukee represents $100 a share paid by stockholders, it would be unduly stretching this principle to assume that these stockholders could expect to be protected from serious losses in view of the nature of the present depression. Losses in a depression are a characteristic of all equity securities.

If, however, the present capitalization of the Milwaukee is studied further, it will be found that the Adjustment 5s represent the old refunding issue, legal for savings banks originally and held today by many savings banks. Not only that, but the Fifty-Year 5s represent in part the new money supplied by stockholders in the last receivership. It is apparent, therefore, that severe treatment of the latter securities might well be considered to be in violation of the Commission's principles as laid down in the O'Fallon case. But, assuming that these securities could justifiably be deprived of their present position, there would seem to be no argument which would justify a dilution or displacement of the old first mortgage, held for many years by the most conservative institutions and regarded in the past as riskless investments. And yet, as has been pointed out, under present conditions a displacement or dilution of this mortgage is necessary if the capital structure is to be so constituted as to attract new money to the property, even temporarily. That such a process will continue to attract that continuous flow of capital necessary to supply the transportation needs of the territory served is unthinkable in the light of either logic or experience.

Proposals to scale the fixed debt of the Milwaukee to a degree that in the past has never taken place or even been suggested, are based on the argument that the road's territory is over-built with railroads and that traffic has declined relatively. This line of argument is based on an erroneous assumption as to the facts. Whatever view may be taken of the earning power of the Puget Sound Extension, 75% of the mileage of the Milwaukee is in Western Trunk Line territory and since 1906, when the prosperity of these roads was indicated by a price of 193 for St. Paul common stock and 240 for Northwestern common,

practically no new mileage has been constructed in that territory. More exactly, the increase in the railroad mileage in states wholly within this territory since 1906 has been 4 per cent and in the states partially in this territory one per cent. Because these arguments are based on an error of fact they do not merely advocate reducing debt in proportion to a lower volume of traffic but advocate reducing debt to a point where the traffic volume per dollar of debt is far in excess of other sections of the country.

The fixed debt of the Milwaukee today, with 30 ton-miles per dollar, is the same in relation to traffic volume as the average of all steam railroads. If the Fifty-Year 5s are eliminated, ton-mile protection is 45 ton-miles per dollar of debt and if, in addition, underlying debt is cut in half, ton-miles per dollar of debt become 90, three times that of the average for the whole country. Such proposals, then, are not to restore the debt of the Milwaukee to a level which is sound in relation to the service performed but to reduce that debt to a point where the service performed in relation to debt is three times that of the country as a whole.

The measure of future capital needs is the service performed; not an arbitrary scaling of present debt. If the Milwaukee must have three times the ton-miles per dollar of debt necessary for the rest of the country, and this condition is to be maintained in the future, it means that every dollar spent by the Milwaukee in the future must be protected by an increase in traffic volume three times that necessary for the rest of the country.

The ultimate objective of railroad regulation by the Interstate Commerce Commission is to supply the country with the most efficient form of transportation at the lowest possible cost. Attainment of this objective requires the maintenance of healthy credit conditions. This, in turn, requires keeping open the large reservoir of low cost money owned by savings banks, life insurance companies and other conservative investors. Sound credit conditions cannot be restored by a slap-dash scaling of fixed charges and capital structures which makes no sufficient provision for raising new money in the future or which assumes a fatalistic attitude in regard to future earnings of the industry. Credit is the state of mind of investors, and the ultimate problem faced by the Commission in its supervision of reorganizations under Section 77 is to provide a cure for the financial weakness which has destroyed in-

vestor confidence in the past. Wholesale conversion of bonds which have been regarded in the past as the highest type of security possible to buy into junior type securities or stock in the hope of being able temporarily to raise a limited amount of money is not a solution of this problem.

Any adjustment in capitalization necessary to create a sound credit structure must do some violence to present security holders. If the standard set-up for the future is ultra-conservative, the degree of violence may be very great.

Unfortunate as this may be, and regardless of the apparent violation of the Commission's principles, it is sound public policy to require security holders to consent to whatever readjustments are necessary to bring about sound credit conditions in the future. What must be avoided, as contrary to the public interest, is a readjustment for the purpose not of creating a sound capital structure for the future but merely in order that new bonds may replace old bonds.

It is one thing to ask a bondholder to release his lien in order to secure a continuous flow of future capital in the right form; it is quite another thing to ask him to release his lien in conformity with a plan for raising future capital in the wrong form, thus repeating the mistakes of the past which are responsible for the present bankruptcy and inviting another bankruptcy.

Mr. Swaine: That is all.

Commissioner Porter: Any questions by anybody?

Cross-Examination.

Q. (By Mr. Weiss.) Mr. Dick, do I understand that unless there is an increase in rates, no plan that is equitable or practical could be evolved in this situation?

A. I think that that is probably true; in other words, my belief is that these increases in expenses that are taking place cannot be denied or ignored, and if expenses continually increase, other things being equal, the revenues received must increase or net revenues will disappear. That is mere mathematics.

Q. Does that represent the view of the Board at the present time?

A. I would say so; yes, without any question at all. It is just mathematics.

Mr. Swaine: I think you want to qualify that; not that no plan is possible, but no plan which will probably do gross injustice to security holders in the light of the ultimate developments.

Mr. Weiss: My question was what was practical and equitable.

The Witness: I thought your question was whether it was the opinion of the Board that increases in costs would have to be compensated for by increased revenues.

Mr. Weiss You have answered the question.

Q. (By Mr. Abrams.) Did you approve the plan of reorganization that was filed the year before?

A. In 1935?

Q. Yes.

A. Yes.

Q. You are acquainted with that plan?

A. Yes.

Q. And did you have your views at that time the same as you have them now?

A. In general, yes, but since that time my studies in regard to the problem of railroad credit reorganizations and future supply of capital have gone away beyond my knowledge at that time.

Q. I call particularly your attention that under the former plan you are to substitute preferred stock for certain mortgage bonds. Have you changed your mind now?

A. I don't quite understand. Will you tell me what you refer to?

Q. I refer to the $182,873,693 Chicago, Milwaukee, St. Paul & Pacific Railroad Company 5 per cent convertible adjustment mortgage bonds. You proposed under the former plan to convert or change these bonds to stock?

A. Yes.

Q. Isn't that correct?

A. Yes.

Q. Have you now changed your mind?

A. No.

Q. Well, didn't you read a long paper here where you tried to convince us that it is unfair to the investors to exchange bonds for stock?

A. Not if it is for the purpose of restoring sound credit conditions in the future.

Q. Well, then, for the purpose of restoring sound credit. Then you can adjust all the mortgage bonds into stock, can't you?

A. Well, I would say that any plan that would really restore sound credit conditions for the future should not be opposed by any security holder of the road.

Q. You are familiar with the many reorganizations that were held in this country, exclusive of railroads, where bonded indebtednesses were exchanged into stock?

A. I am.

Q. Do you think that that in any way affected the investors' investments in securities?

A. Sometimes very seriously. Every investor in securities, who is basing his opinion on investments, takes into consideration the record of earnings of any industry, or the type of industry and the bad record of losses which affects them. There is no question about that.

Q. But, you know many reorganizations were had in this country where the entire bonded indebtedness was changed to stock, preferred and common?

A. Yes; I think that has been done.

Q. Would not a plan of this nature be feasible or practical in this railroad reorganization?

A. If you could raise your new money without selling any new bonds. The point is, if you would take your bonds off, to get a sound capital structure to maintain itself, I think there would be no dispute, and if all bonds were like that, taken off and lifted permanently and raised that money in the future without selling any bonds, I would be for it. But, how could you do it?

Q. Did you make a study of this kind?

A. Yes. I don't think it would be in the public interest, but if the assumption were right that you could raise new money from stock without selling any bonds, then you could justify, say, removing all bonds. But, you have to remember this: When you talk of selling stock of that character, you are dealing with speculators or investors of a different type than savings banks. It costs you more. The speculator wants more. If I try to sell you a speculative stock, you want a bigger return than if I try to sell you a good bond, and if the railroad industry is to change its source of capital from speculators and eliminate the savings banks, they have to pay more for it, and they should not pay any more than is necessary to maintain sound credit conditions.

Mr. Abrams: That is all.

Q. (By Mr. Weiss.) Isn't that inconsistent with the

treatment which the people who put new money in the last reorganization get under this plan?

A. I don't follow you.

Q. Well, in the old plan, $70,000,000 was put up—I think the 5's.

A. Yes, sir.

Q. Now, they have been treated worse than the persons who held the first liens; the lien that was foreclosed in 1928?

A. No. The bonds that were foreclosed in 1928 was the refunding mortgage.

Q. Or general mortgage bonds now.

Mr. Swaine: Yes.

A. They are adjustment mortgage bonds now. The present adjustment mortgage represents the old refunding mortgage which was foreclosed in 1928, isn't that right?

Mr. Swaine: That is right. The old financing mortgage prior to the 1928 reorganization is now represented by the adjustment mortgage. The new money that went into the old reorganization is now represented by the 5's of 1975. The present general mortgage was undisturbed in the previous reorganization.

Mr. Weiss: That is precisely what I say. They were continued from the old company, were they not?

Mr. Swaine: They were senior to the previous new money bonds.

Mr. Weiss: I understand that very well, but the people who put up money after the senior bondholders got 5's of 1975.

Mr. Swaine: That is right.

Mr. Weiss: And they are getting worse treatment than those who had the $75,000,000.

The Witness: They had a prior lien.

Mr. Weiss: Are they getting better or worse treatment? That is the question I am asking.

The Witness: Naturally, in any reorganization the holders of the First Mortgage get better treatment than the Second Mortgage, if the plan means anything in the world, or he should.

Q. (By Mr. Weiss.) To be consistent, if the Railroad credit is based upon fair treatment of securities, particularly those putting in fresh money, the 5's of 1975, should get a better treatment than the new General Mortgage Bonds?

A. That is a new method to me. That is that the last

security holder putting up his money gets better treatment, whether common stock or no matter what it is. It is a new treatment to me.

Mr. Weiss: That is all.

Mr. Swaine: That is all the Debtor has unless there are further questions.

Mr. Clay: There is one point, Mr. Dick, which I want to get a little more clearly.

The Witness: Yes, Mr. Clay.

Q. (By Mr. Clay.) Would you be good enough to explain the medium of financing?

A. A railroad attracts new money by selling fixed interest bonds and can attract new credit by selling fixed interest bonds.

Q. I was asking with relation to the 1935 plan.

A. We recognized in that plan, as the record in this case shows, the economies of it, and we had no adequate financing medium in that plan, and, as you will recall, there was an agreement made with the Reconstruction Finance Corporation to temporarily supply funds for improvements to I think it was 1940 or 1941, and with the expectation that by that time conditions would improve so that we could develop a financing medium to get money from the public and probably pay off the Reconstruction Finance Corporation.

Mr. Swaine: There was one other element, a capital fund.

The Witness: There was one other element, a capital fund, plowing back the earnings.

Q. (By Mr. Clay.) Was there any bond issue provided that fairly could be expected to be used as a medium of public financing?

A. Under the 1935 plan?

Q. Under the 1935 plan.

A. Not under the conditions at that time. That is why we went to the Reconstruction Finance Corporation for the purpose of what you might call this underwriting.

Q. The 1935 plan provided a medium of financing only through the Government?

A. I won't quite say that, because it was not beyond the realm of possibility that conditions with traffic increasing could have improved sufficiently by the time that the plan was consummated, so that the Reconstruction Finance Corporation underwriting might not have been required.

It might not have been required but, obviously, it was necessary to have that underwriting at that time.

Q. Assuming that there had been an adequate increase of earnings?

A. Yes.

Q. What issue of bonds would constitute the medium of financing?

A. We had authorized the refunding mortgage for new bonds for new money.

Mr. Swaine: That is a first lien on the Lines West, is it not?

The Witness: That would have been a first lien on the Lines West, and it would be subject to the General Mortgage, the Milwaukee and Northern, the Terre Haute Lease.

Q. (By Mr. Clay.) You read a long statement which was partially opinion. Assuming that the earnings did increase, would it, in your opinion, be possible to market those bonds on advantageous terms?

A. The refunding mortgage?

Q. Yes.

A. Oh, yes. In other words, fundamentally based on your traffic, all the standards which we used were customary standards and assumed a proper adjustment, but your expenses and your revenues on the Milwaukee were such that your refunding mortgage bonds would rate as very good bonds.

Q. That was the only medium which might be considered a medium of sound financing?

A. Yes.

Q. Do you consider the plan feasible now?

A. Obviously, with the underlying mortgage bonds selling at 40, the prospects of selling that refunding mortgage today, in the immediate future, is just out.

Mr. Clay: That is all.

Mr. Swaine: That is all.

(Witness excused.)

Mr. Swaine: That is all the evidence that the Debtor has, and the Debtor requests an adjournment of this hearing until sometime in January.

Commissioner Porter: Any evidence to be offered by anybody else?

Mr. Weiss: I would like to make a statement which I understood I would be permitted to make before the close of the hearing today.

Commissioner Porter: A brief one, yes, sir.

Mr. Weiss: Yes, sir.

Commissioner Porter: Is there any further testimony to be offered by anybody?

(No response.)

There seems to be none.

Mr. Abrams: I just wanted to make a statement on the question of continuance, but not to offer any evidence.

Mr. Burgess: I have a little statement to make, but I would be perfectly willing to let Mr. Weiss go ahead.

Commissioner Porter: You may proceed, Mr. Weiss.

Mr. Weiss: Is it all right to be seated while I read?

Commissioner Porter: That will be all right.

Mr. Weiss: The plan does not meet with Subdivision B-77, in that fixed charges are not covered by the probable prospective earnings, in the light of the company's earning experience.

The plan provides for fixed interest charges of $7,147,146, contingent interest charges of $7,453,840.

The average earnings of the road—

Commissioner Porter: Pardon me, just a minute. I am just wondering, from the little which you have already read, would not that be matter which might properly be put into a brief and submitted to the Commission, rather than as evidence in the record. Do you not think so?

Mr. Weiss: It is a critical analysis, very brief, of the plan as submitted, and which will of course, have some bearing on any new plan, because this plan, if it is going to go through a mere amendment or a modification here and there, which is a makeshift modification, will certainly not satisfy our committee.

We feel that what is required here is a thorough going reorganization.

Commissioner Porter: I am just wondering, assuming, of course, that is your feeling, would it not be better to embody that in a brief, do you not think, and submit it to the Commission, rather than as evidence? That is the point that I was raising.

Mr. Weiss: It is immaterial to me, as long as it gets into the record and before the Commission.

Commissioner Porter: The question in the Director's mind and mine is that it is not strictly evidence but, of course, it would be very proper in any brief that you want to file to help the Commission in arriving at a solution of this matter.

Mr. Weiss: It is just as much evidence as Mr. Dick's opinion in giving his views, the views of the Board of Directors. I do not see that there is very much distinction between the statement which I am going to make and the character of his statement. Neither of them are anything but points of view.

Commissioner Porter: Probably we were pretty liberal in letting Mr. Dick make his statement, rather than have him submit it by brief.

Mr. Weiss: As long as I am permitted to submit this in some form to the Commission, and it forms part of the record, I believe the situation will be met that way, but I do wish to make this statement, in any event.

That with respect to a continuance, I think that more than enough time has elapsed since this management first devolved its plan, and the manner in which the development of the plan was approached indicates, to my mind, certainly an ineptness to reorganize, and that the men who are responsible for that plan demonstrated their unfitness to make any sort of a plan.

I think that this application which they made for an adjournment or continuance of more time is certainly a confession of failure. They cannot go on. Uncertainties exist. Uncertainties always exist. They knew that before, and they knew that eight years ago when they formed their other plan.

It seems to me that the time has come for the Commission to write a plan itself in this cause, and I had thought in this memorandum, which I wrote out here, to indicate to the Commission certain lines of procedure and certain treatment which should be given to the security holders in any plan which may be developed.

Commissioner Porter: I am still of the opinion that the best way to do this is by brief rather than by reading it into the record.

Mr. Weiss: I shall abide by whatever suggestion you think is appropriate.

Mr. Swaine: The Debtor would be very happy to have the suggestions of the independent committee. It has requested them several times in public hearings, and is yet to receive any suggestion from the Weiss Committee, and we would like very much to have them. So that I hope that your suggestions can be promptly submitted and copies of this statement supplied to all parties to the record.

Mr. Weiss: I should be very glad to do that. And I may state, this is the first time Mr. Swaine has made such a request, but, late as it may come, I am willing to comply with it.

Commissioner Porter: Mr. Abrams.

Mr. Abrams: I would like to urge upon the Commission not to give the continuance unconditionally. This property has been in reorganization constantly. It had been up to 1928, and only a short period went by and another reorganization petition was applied for.

It is not the object of Section 77 to come into a court under 77-B and to repeat the evils of equity receiverships by throwing a company into receivership and prevent creditors from taking their legal steps.

The effect of this reorganization and the granting of continuance without anything definite is to stop creditors from pursuing their legal remedies.

If they want a reorganization let them have it. If they cannot carry out the reorganization let them dismiss the proceedings and let the creditors go and do whatever they can.

Your Honors will recall that in 1935 when I appeared and examined some of the witnesses, their testimony was altogether different with their statements today. The record is here.

They now admit what I contended in 1935, that the other plan, if carried out, after its completion would predicate another reorganization immediately thereafter. They now admit that it cannot go through under that plan.

I am very much opposed to committee plans. The report of the Securities and Exchange Commission on Committee Reorganizations is printed, and I invite everybody to read the report—and I suppose you have already read it—which shows the evils of committees. 99 per cent of the committees are organized not to protect the public but to protect the committees and to protect persons interested, who have certain conflicting interests.

It is about time that the public itself should have a representative to work out a reorganization, and my suggestion is that this Commission ought to appoint a Board of reorganizers, one, two or three persons, and let them cooperate with the committees, but let this board between now and the next time that the hearing will be adjourned to try to work out a plan which will be fair and equitable to the investors.

In the original plan which was presented—

Commissioner Porter: May I suggest this:

I understood you wanted to address us not on the question of the merits of the plan, but on the question of whether or not the hearings are to be continued.

Mr. Abrams: I am not going into that.

Commissioner Porter: All right.

Mr. Abrams: So that my suggestion is that if any continuance is to be granted, that it should be conditional, and that the Commission should appoint a board of reorganizers, that will present to the next hearing a modified plan of reorganization.

Mr. Weiss: With respect to a continuance, I will say this, Mr. Commissioner, that you should bear in mind that what the Debtor has in mind is an increase in rates. The Commission might just as well disabuse their minds of that right now. If they are going to wait for a plan which will depend upon increased rates, they are going to wait longer than 120 days.

Mr. Clay: If they get increased rates, their excuse will be that they have to have six months more to see how the rate increases are reflected in the earnings of the property.

Mr. Swaine: I do not think that is quite a fair statement of the attitude expressed by either Mr. Scandrett or Mr. Dick, and I am frank to admit that there is a slight difference in that expression.

I think they say, taking them together briefly, that it is very unwise to project the plan today, because it is going to produce an unfair result to certain classes of securities.

The Commission says we have got to try. We are therefore, ready to sit down and try to evolve a sound capital structure, based upon the present earnings record.

We have no doubt that we can arrive at a result which will produce something which has the superficial appearance of a sound structure. We do believe, however, that when we have got this it is going to be objected to particularly by the Junior Securities, and we think it is going to require such violence to senior securities that it will probably be objected to also by them, but we are expressing our willingness to make the effort.

Mr. Weiss: That is precisely the point. We do not want another paper structure.

Commissioner Porter: Mr. Burgess.

Mr. Burgess: If there is to be another hearing, it would

seem quite unnecessary for me to burden the record now with any extended statement or showing on behalf of this Committee of Institutional Investors that Mr. Walker represents, as Chairman, but I would like to make—

Commissioner Porter: If you have any showing, I will be frank to say to you that you had better make it now.

Mr. Burgess: I would like to make two statements.

Commissioner Porter: Very well.

Mr. Burgess: In the first place, our group does not want to delay this reorganization, and we do not share the view expressed by Mr. Dick that this is a moratorium statute. As we read this statute, it requires a prompt reorganization, and it puts it into the hands of the Commission, to see that such a prompt reorganization is carried out, or the Commission may recommend to the Court that the proceeding be dismissed, if there is an unreasonable delay.

As far as our committee is concerned, we do not want to delay the reorganization of this property. On the other hand, we own about $80,000,000 of securities of this Debtor, and that represents money that was invested, that was contributed by insurance policy holders and by savings bank depositors, and this is not a matter which can be dealt with in any cavalier manner. It is a matter which requires the judgment, and the best judgment of all of us.

We agreed on the part of our committee to this stand-by plan with the thought in mind that it would expedite the reorganization of this property. We agreed to that with the idea that it would be put through promptly.

It must be borne in mind that the very pendency of this proceeding under Section 77 stays our hand to exercise our contract rights to foreclose the mortgages where there have been defaults and that Section 77 was not enacted by Congress as a moratorium statute, and if it had been enacted as such, it would have been unconstitutional.

It was a plan in which our rights are held in abeyance for a particular purpose, and that was to effectuate a plan of reorganization, a plan proposed by the Debtor.

Now, we arrive at this particular point today, where the plan of reorganization that is pending before the Commission, that was proposed by the Debtor, is now characterized by the President of the Debtor as being undesirable to be put into effect at the present time, and is characterized by one of the Directors who has testified as being unworkable, undesirable, and altogether impractical.

The statute provides that this proceeding that we are sitting here in today is to be inaugurated by the filing of a petition by the Debtor, asking for reorganization, in conformity with the plan of reorganization, and the statute directs that the Debtor shall present a plan—it is mandatory—and that the Commission shall proceed to hear that plan, unless it finds that it is impractical.

Now, the effect of what has been happening here this morning is to characterize the only plan that is before the Commission as impractical and substantially to withdraw it.

The statute also provides that we, as creditors may, with the consent of the Commission, during the pendency of this proceeding, if we are so advised, present a plan of our own, but the primary duty and the jurisdictional fact that must be here, if the Commission is to proceed, is to have a plan presented by the Debtor.

We think that some of the reasons which have been advanced by the Debtor are very cogent reasons for not proceeding to close this record, in consideration of this present plan.

We think that facts have transpired and new conditions have been created that make it probably impractical to reorganize this corporation on the basis of this standby plan, and we are perfectly willing to enter into any negotiations with the Debtor looking toward the evolvement of a new plan, if we can agree, or if we cannot agree then we think that the Commission should indicate very clearly to the Debtor that if a postponement is granted and there is no agreement or no agreed plan, that the Debtor should comply with the mandate of the statute and present a plan that it does think is practicable and workable for reorganization under present conditions and we ask that that be done.

Director Sweet: Mr. Burgess, would it not follow from what you have said, possibly, that the thing to do would be to require the dismissal of the proceedings before the Commission on the plan?

Mr. Burgess: We think not, for the reason—

Director Sweet: If there is a plan here which is wholly impractical, that certainly is prima facie impractical, the Commission is not required to conduct any hearings with reference to any such plan as that, and why does not what you have said indicate that the thing to do is simply to dismiss the proceeding on the plan and wipe the slate clean, just as if there were no plan before the Commission?

Mr. Burgess: I would quite agree, your Honor, if the President of the Debtor had not testified but a few minutes ago that it would be his purpose to recommend to his Board the presentation of a new plan, in the event that there can be an agreement, and it seems to me that with the Commission having been charged with the responsibility and having proceeded within the last two years to attempt to work it out, now at a time when the President of the Debtor states that some other new conditions make it desirable to have a new plan, and in view of that asserted statement, if there is one prepared, that it would be quite a mistake not to do it.

Commissioner Porter: Is not this the difficulty about all that, Mr. Burgess:

You have said, this is a plan which has been pending for two full years. At the last hearing I warned everybody in language which certainly was plain and not subject to misunderstanding that this would be the last hearing, unless an application was filed, which the Division considered meritorious.

Now, it seems to me that under circumstances of that kind, and with no assurance from the President of the Debtor or of anybody else, that if this hearing is adjourned there will be something brought before us, then the question comes up, does it not, according to your own argument, that it is the duty of the Commission to see that this is gone forward with with the utmost possible speed, having of course in mind at all times, the rights of everybody in the proceeding.

Now then, that being true, is not the only thing for the Commission to do to close this hearing and do the best it can, rather than bringing the matter forward for the consideration of everybody, when nobody here says definitely to the Commission that if this case is continued they will be here with something?

Mr. Burgess: I have very grave doubts, your Honor, whether the Commission has jurisdiction to do that. It seems to me that the statute, as I read it, makes the jurisdiction of the Commission wholly dependent upon acting upon a plan of the Debtor. If what the Debtor has done this morning is to be construed in practical effect as the withdrawal of its plan, I should have grave doubts as to whether the Commission would have the jurisdiction to go ahead and make a plan of its own.

I think, answering the second point of your observation,

that it would be a very serious mistake for the Commission to close this record today, when the President of the Debtor has stated here that this plan has become unworkable for reasons which he has mentioned and asks for a hearing or a postponement of only 120 days in which to confer and attempt to evolve a new plan.

We ask that that request be granted, but we also ask that the Commission indicate that it will not expect to have presented to it, in the event that we cannot agree on the plan, a plan which the Debtor thinks would be proper to reorganize this railroad under present conditions.

Mr. Swaine: Or, in the alternative, a statement by the Debtor that it is willing to have the proceeding dismissed. Is that not right?

Mr. Burgess: That is up to the Debtor.

Mr. Weiss: Mr. Commissioner, with respect to the question of power, which Mr. Burgess raises, I agree with him that the plan is a plan suggested by the Debtor. That is a jurisdictional fact. The statute also says that the Commission may render a report and order in which it will approve the plan which may be different from any which has been presented.

In other words, the alternative here is not dismissal but another plan.

I do not think that this Commission loses its jurisdiction because of the confession that this plan is not feasible.

Mr. Burgess: Mr. Walker directs my attention to this additional consideration, which perhaps I should mention to your Honor, although I think it is premature.

Commissioner Porter: Yes, sir.

Mr. Burgess: That it may well be that in the event that these negotiations which have been contemplated and which we have asked to enter into by the Debtor, should fail to bear fruit in the way of an agreed plan, and that the Debtor should present a plan, it may well be that we will avail ourselves of the opportunity given by the statute, to ask the Commission for authority to present a plan of our own.

That, however, will have to wait the outcome of these negotiations.

Certainly the situation that has developed here I think indicates quite clearly that the parties must proceed to undertake to effectuate a reorganization, and that, as I understand it, is the only request that is now pending, to carry that out.

Commissioner Porter: Does anybody else here desire to be heard on this matter at this time?

Mr. Bagon: I do not believe anyone represents the unextended Milwaukee and Northern Consolidated Mortgage Bonds. I would like to ask whether the Debtor welcomes any suggestion from myself or other attorneys representing similar holders of such bonds?

Mr. Swaine: Certainly. The Debtor will be glad to have suggestions from any security holders.

Commissioner Porter: May the record show this:

As I have suggested already, when Mr. Burgess was speaking, I said at the last hearing that unless an application were made to the Division having charge of these matters, that I would close the hearing at this time. That application, as has been indicated here this morning, was made to the Division by the President of the Debtor Company, and was considered carefully by the Division, and in that consideration there had also been circulated, I may say, to the Division a synopsis of the testimony of the Committee that testified at the last hearing, giving their reasons at that time why they thought this matter ought to be further continued.

So that the Division had before it, everything that I as a Commissioner, and the Director and the Director and the Examiner have before us this morning, because we had the testimony, as I said, of the Committee, that is a synposis of it, and we had before us the petition of the President of the Debtor.

The Division gave, I think, very careful consideration to all of the grounds that were urged in that petition at that time.

Now, all of us up here are agreed that nothing has occurred here this morning that changes that picture from what it was when the Division considered the matter the other day, and that being true, I have nothing else to do but to declare this hearing and this record closed.

Now, do the parties desire to file briefs, and, if so, how long a time do you want to file briefs in?

Mr. Burgess: I should like to have the matter appealed from the ruling of the Commissioner and from the ruling of the Division to the full Commission, and in connection with so doing, I would like to make a showing.

Commissioner Porter: You have the right, of course, to do that under the rules.

Mr. Burgess: I would like to call Mr. Walker to the stand.

Commissioner Porter: You mean now, on a petition to the Commission?

Mr. Burgess: Yes.

Commissioner Porter: All right.

FREDERICK W. WALKER was sworn and testified as follows:

Direct Examination.

Q. (By Mr. Burgess.) What is your name, Mr. Walker?

A. Frederick W. Walker.

Q. Where do you reside, Mr. Walker?

A. Milwaukee, Wisconsin.

Q. What is your occupation?

A. I am Vice President of the Northwestern Mutual Life Insurance Company, in charge of bond investments.

Q. What is your relation to the group of institutional investors that has been permitted to intervene in this proceeding?

A. I am Chairman of that group.

Q. What, in general, is the nature of that group? Is it the owner of securities of the Debtor?

A. It is.

Q. Do the members of that group own some of each of the several bonds of the Debtor?

A. Yes, I so believe, with the exception of the unextended Milwaukee and Northern bonds. I believe that there are none of those owned by any members of the group.

Q. Do you recall, Mr. Walker, the approximate total of the face value of those bonds?

A. I do not offhand recall that amount. I think it is somewhere in the neighborhood of $80,000,000.

Q. As the Chairman of this Group of Bondholders which have been permitted to intervene, what have been your activities in connection with the proceeding initiated under Section 77 of the Bankruptcy Act by the Debtor here? What in general have you done?

A. In connection with counsel for the Committee, we have followed everything which has transpired before the Commission and in the Court. We have also carefully followed the earnings and the operating expenses. We have gotten from the management their budgets of improvements and betterments and we have followed along

from month to month and year to year the result of the operations, compared to what was anticipated in 1935 as to what the results would be during the so-called stand-by period of the plan, which carried through for a maximum in the forecast presented by the Debtor to the year 1940.

Q. Did you make an inspection of the property of the Debtor?

A. I went over the main line of the Debtor, personally to the Pacific Coast. I did not go over the branch lines. I am fairly familiar with a number of its lines in the State of Wisconsin, in addition to main line, but I went over the line from Milwaukee to the Coast to satisfy myself as to its condition of maintenance.

Q. In that connection, have you had any engineering training or experience?

Commissioner Porter: What has all this got to do with the question of whether or not the Division shall be overruled or sustained?

Mr. Burgess: I think, your Honor, it has the greatest direct importance on whether the Division should be overruled or sustained, and I will undertake to show that, if I am permitted to argue the matter orally before the full Commission.

Commissioner Porter: I doubt if you will be granted the right, because it has never been the rule here, as I understand it, to allow counsel to argue orally motions of the kind which you say you are going to file.

It never has, during the years I have been a member of the Commission. I will say that frankly. Do you recall any such case, Mr. Burgess? You have been practicing before us longer than that.

Mr. Burgess: I do not recall any proceeding which is analogous to this in its nature.

Commissioner Porter: This is governed by the regular rules of the Commission, and you have filed dozens of petitions for rehearing before the Commission, both you and your colleague, and I do not recall any instance where anyone has ever been heard on these petitions.

Mr. Burgess: I think I can satisfy your Honor with authority, that where matters have been appealed upon rulings of this kind, for the purpose of decision before the full Commission.

Commissioner Porter: Yes, on the petition which you filed in writing or printed, asking for the rehearing, but never in the ten years that I have been here, have I heard

of the Commission hearing oral argument on that petition until after it is granted, and then it is on the merits of the case.

Mr. Burgess: It may be that the Commission will not grant it. I shall ask it.

Commissioner Porter: I am not saying what the Commission will do. I do not know a bit more than you do, Mr. Burgess. They do unexpected things sometimes to me.

Q. (By Mr. Burgess.) I had asked you, Mr. Walker, what in general had been your experience as an engineer?

A. I am a mechanical engineer, graduated from the Stephens Institute in Hoboken, New Jersey in 1895, and I followed engineering practice until 1926, when I was elected a vice president—

Mr. Abrams: I want to object to this evidence altogether, which is incompetent, irrelevant and immaterial to the issue now.

Commissioner Porter: I just asked Mr. Burgess about that. I do not see what it is relevant to on the question of petition for rehearing, whether or not Division 4 shall be overruled or sustained.

Mr. Smith: May I say a word about that if you please?

Commissioner Porter: Surely.

Mr. Smith: When the Commission or the Commissioner suggests or rules that this record be closed at this juncture, we are not advised, of course, from that bare ruling as to what the purpose of the Division or the Commission may be with reference to the future of this proceeding.

Commissioner Porter: I can tell you frankly—

Mr. Smith: I think that would clarify the situation, if your Honor would do it.

Commissioner Porter: It is my understanding that the hearing of this bankrupt proceeding is now closed. Opportunity will be given to everybody that has appeared in the matter to file briefs, to aid the Commission, just as far as possible in its consideration of the plan as filed, or if your position is that that is not a proper plan and you want to make suggestions as to the kind of plan that the Commission shall offer to the public and to all the parties, why, you are to be allowed that liberty surely, Mr. Smith.

Mr. Smith: Perhaps I misunderstood an observation that one of your Honors made a few moments ago, but, as I understood it, there was some suggestion that considera-

tion would be given by the Division to the propriety of recommending the dismissal of this case.

Commissioner Porter: You will remember, Mr. Smith, for illustration, that in the Frisco Case, where the record was closed and was taken under advisement by the Commission, by the Division, there the Division, after considering what had been placed before it and the record which it had, then did decide that it did not have a record upon which it could offer a plan, and that the plan which had been presented was clearly inadequate, and dismissed the proceeding.

Mr. Smith: All right, your Honor—

Commissioner Porter: I assume that the Commission could do that in this case. I am not saying whether it will or will not do it, you understand.

Mr. Smith: All right. The record which we have now, then, is that on the basis of this proceeding being closed, so far as the making of a record is concerned, the Division or the Commission will be prepared to give consideration to whatever it deems proper, including among the possibilities dismissal of the proceeding, on the one hand, or the promulgation of a plan on the other hand.

Commissioner Porter: Absolutely, or changes and amendments, of course, in the plan, Mr. Smith, as offered by the Debtor.

Mr. Smith: Our position with reference to that, and as to why the evidence which we now propose to offer as a basis for our appeal from such a ruling to the Commission itself is this:

That there is not now in practical effect a plan before the Commission—

Commissioner Porter: Now, won't the record have to speak as now made, and closed?

Mr. Smith: Yes. I am stating what our position is.

Commissioner Porter: I understand.

Mr. Smith: And why we think this evidence is relevant.

Now, if there is no plan before the Commission, as under the circumstances we shall contend, then we shall insist that the creditors whom we represent insist that they shall have an opportunity, first, to examine a plan submitted by the Debtor, which the Debtor now says it is ready to undertake immediately to work upon; and, secondly, we say that it is our right under the facts, having had an opportunity

to consider the plan of the Debtor, to ask the permission of the Commission to submit our own plan.

Now, if the Commission decides that it is not going to proceed—

Commissioner Porter: If I will open the record, will you submit a plan in ninety days, a bona fide plan of reorganization of the Milwaukee?

Mr. Smith: May I get to that in just a moment?

Commissioner Porter: All right.

Mr. Smith: Now, secondly, if the Commission says that there is a possibility here that it ought to dismiss this case, or recommend to the Court that it dismiss it, I call the Commissioner's attention to Sub-Section G of the Act which says that that may only be done by the Court.

Commissioner Porter: Yes.

Mr. Smith: Not by this Commission but by the Court.

Commissioner Porter: Yes, sir.

Mr. Smith: Upon the facts of undue delay having been established.

Now, Mr. Walker's testimony here is going precisely to that point, among others, to show that there was an agreed plan here, which was expected by both parties as possible of consummation up until June of this year; that events have supervened since then that have so added to the doubts of the feasibility of that plan it is now felt not to be feasible.

We propose to show that those circumstances which have developed do not contribute undue delay, if the Commissioner please, up to this point.

Commissioner Porter: Is not that question for the Court to decide, just as you suggested, and not in this appeal? That is my point.

Mr. Smith: The Court acts upon a recommendation of the Commission, or at least it has before, upon a recommendation of the Commission.

Commissioner Porter: Yes, sir.

Mr. Smith: Our testimony here will be designed to inform the Commission as to whether it conceivably could make a recommendation to the Court that under the circumstances here there has been any undue delay.

Commissioner Porter: But the record, as made, will have to speak on that, won't it, and you cannot supplement that record or determine there has been undue delay by this witness now?

Mr. Smith: Why not?

Commissioner Porter: We have got the whole record, commencing with the presentation by the Debtor of its plan, and if this Commission shall in the future then make the recommendation which you suggest we make, then won't the Court have all that before it as to what has happened and what has occurred, and this witness cannot help in the matter in any way.

Mr. Smith: If you please, the question as to whether there has been any undue delay here involves a question of a great many elements, the character of the problem that is involved and the question as to what has been done in the direction—

Commissioner Porter: Has not that been fully set out there by witnesses this morning and at the last hearing, and by Mr. Scandrett every time I have heard him—with pleasure always.

Mr. Smith: It has not been as fully set out as I should like to have it set out, and we should like to have that aspect of the matter amplified by Mr. Walker.

Commissioner Porter: The objection made by Mr. Abrams is sustained.

Mr. Weiss: I call the Commission's attention to this statement in the plan;

That numerous conferences on this tentative plan were held with representatives of the largest security holders, resulting in important modifications which are incorporated in the following plan of reorganization.

The security holders mentioned there are the security holders represented by Mr. Walker's Committee. In other words, they participated in this thing before the plan was submitted to you, and their modifications and views are incorporated in it.

Mr. Burgess: Then, Mr. Commissioner, I desire to make this offer of proof—

Commissioner Porter: All right.

Mr. Burgess: I desire to offer to prove—

Mr. Abrams: May I, your Honor, object to an offer of proof of this kind when the case is closed?

Commissioner Porter: I think counsel has the right to make an offer of proof. As I understand it, counsel says to me and to the parties here that he is going to file a petition for reconsideration by the entire Commission of my

ruling this morning closing the record, and he desires now to make an offer which he claims is material in this matter.

I think he has that right.

Mr. Abrams: Let me make this suggestion:

An offer of proof is proper when a case is open, when a witness is presented, and when the evidence is excluded counsel has a right to make an offer of proof. But when a case is closed and a question comes up on the matter of appeal, there cannot be such offer of proof when the case is closed. That is my point.

Commissioner Porter: I will overrule it. Let counsel make this offer.

Mr. Burgess: We desire to prove by Mr. Walker that there has been no undue delay in a reasonably expeditious reorganization of the Debtor.

We desire to prove that throughout the period during which this proceeding has been pending before the Commission, there has been close contact and observation by the Committee of which Mr. Walker is Chairman, with the operating and financial results of the Debtor.

That until the hearing of June 16th, 1937, there was no presentation made to the Committee represented by Mr. Walker that there would be a desire to change or modify the stand-by plan of reorganization prepared by the Debtor, and agreed to by our Committee.

That following the hearing on June 16th, 1937, at which time I specifically asked counsel for the Debtor whether the plan had been withdrawn, and was assured that it had not been, our Committee examined the evidence presented by the Debtor at that hearing and prepared to make comments thereon at this time.

That on September 10, 1937, ten days ago, our Committee received the following letter signed by Mr. Robert T. Swaine, Counsel of the Board of the Chicago, Milwaukee St. Paul and Pacific Railroad Company, addressed to Frederick W. Walker, dated September 9, 1937, reading as follows:

"Dear Mr. Walker:

"There is enclosed a copy of an application being made to the Interstate Commerce Commission for further adjournment of the Milwaukee Reorganization proceedings. If reorganization is to be forced at this time, consideration must be given to modifications of the 1935 plan to deal with:

"(1) Provision for a financing medium.

"(2) Changing the fully cumulative feature of the fifty year bonds to provide for accumulation of interest on those bonds against income for only some limited agreed period.

"A special committee appointed by the Board to consider reorganization problems would appreciate an opportunity to discuss such modifications with you at your early convenience.

"Very truly yours,
"Chicago, Milwaukee, St. Paul and
Pacific Railroad Company,
By Robert T. Swaine,
Counsel for the Board."

That on September 13, 1937 Mr. F. W. Walker wrote to Mr. Robert T. Swaine, saying that he acknowledged receipt of this request, and that the Committee of which Mr. Walker was Chairman would be ready at all times to discuss reorganization problems that might arise, including those mentioned by Mr. Swaine.

Since that time there has been no opportunity to have a meeting of the Committee of which Mr. Walker is Chairman, and of which some of the principal officers of large insurance companies and savings banks are members.

That there has been no opportunity since that time to give consideration through an appropriate committee meeting as to whether or not this committee of creditors should apply to the Commission for authority to present a plan of reorganization of its own, having in mind the provision of Section 77 of the Bankruptcy Act that after the hearing has started creditors may only present a plan of reorganization upon receiving the consent of the Commission

That these circumstances have all changed the situation within the last ten days as to deprive the Committee representing $80,000,000 of the holdings of life insurance policy holders and savings banks depositors of their rights.

That there has been no undue delay on the part of our Committee, and that in the opinion of the witness, Mr. Walker, who has been closely identified with this reorganization, there has been no undue delay on the part of the officers of the Debtor.

That is the showing which I desire to make by this witness, and I make that offer of proof and ask that it be considered, and that we be given an opportunity to pre-

sent our request to the full Commission that the ruling of the Commissioner closing this hearing at this time, and thereby depriving us of the right even to give consideration to the presentation of a plan of reorganization of our own, is erroneous in law and in fact.

Commissioner Porter: The Commissioner will hold that, as he understands it, the only matter before him at this time, is whether or not he has erred in closing this hearing at this time; that from the ruling of the Commissioner and the Director and the Examiner in closing the hearing, counsel intends to appeal to the entire Commission, which of course I hold that he has an absolute right to do under our rules.

But I do hold that the offer on that question is entirely incompetent, immaterial and irrelevant to the only question which will be presented to the entire Commission.

Mr. Abrams: May I move at this time to strike the offer of proof from the record on these grounds:

That before the case was closed the Commissioner asked everybody to offer any evidence that they desired, and in accordance with the request made to offer any evidence, Mr. Burgess did not offer any evidence that he had. Because of this fact and the impropriety of making an offer of proof after a ruling, I move that this entire offer be stricken.

Commissioner Porter: The motion is overruled.

Mr. Burgess: Your Honor, might we have a recess for five minutes? As I understand it, the question which you interrogated Mr. Smith about was whether, in the event that there was a postponement, I think he used the term of ninety days, whether the committee would undertake to present a bona fide plan. I should like to confer with Mr. Walker concerning that, if you will be good enough to do this. This is a serious occasion.

Commissioner Porter: We will adjourn for five minutes.

(Thereupon a five minute recess was taken for the purpose of conference between the parties, after which the proceedings were resumed as follows:)

Mr. Burgess: Mr. Commissioner, the question which you addressed to Mr. Smith, as to whether or not the Committee of which Mr. Walker is Chairman would undertake to produce a plan, is a question that I would like, with your permission, to have Mr. Walker answer rather than undertake to do it myself.

Commissioner Porter: All right.

The Witness: It is my opinion, as Chairman of the Committee—and I am very strongly of the opinion that will be the decision of the Committee—that upon taking up the negotiations with the Debtor Corporation to determine just what are their ideas as to the extent of the modifications of the 1935 plan, not limiting those modifications to the two points which were specified in Mr. Swaine's letter as counsel for the Board, and as my reply to that letter stated, that the Committee would be glad to discuss any problems which the Debtor Corporation had to suggest in connection with the plan, that the Committee can very promptly reach a conclusion as to whether it could agree with the Debtor on a modification of its plan; and that if it reached the conclusion that it could not agree upon a modification of the Debtor's plan, it is my opinion that the Committee would proceed forthwith to produce a plan of its own, which it would apply to the Commission for the right to file.

The question of the length of time necessary to produce a plan that would be in form for final filing with the Commission, and to produce the necessary evidence in support of a plan is a more difficult question to answer, in my opinion, than whether or not the Committee will proceed to produce a plan of its own.

By reason of my close contact with the members of the Committee during this period of time since 1935, my own personal opinion is that they will promptly decide, in the event that no agreement is reached with the Debtor with respect to a modification of its plan, that they will promptly decide to proceed with a plan of their own.

There are a number of different mortgages and there are a number of different classes of claims, and to produce a plan in final form under which the various classes of creditors will agree, or at least a number of the various classes of creditors will agree that that plan is in satisfactory form, is a very difficult matter for which to fix the length of time.

I think I can give to the Commission the assurance that our Committee would use its very best endeavors and earnest effort to produce within 120 days from the present time a plan of reorganization of its own, if unable to agree with the Debtor Corporation on a modification of the 1935 plan.

Now, it may seem to the Commission as though our committee, and as though personally I have been some-

what remiss in not proceeding heretofore and prior to this time upon a plan, but I would like to call to the Commissioner's attention two things.

In the first place, when the 1935 plan was formulated, and when the plan was filed with the Commission, there was a forecast of probable operating results in the form of Exhibit No. 96, which was introduced during the August hearings. That showed what at that time it was expected would be the effect and the working out of this 1935 plan.

During the first eighteen months, namely, the last six months of 1935 and the first year of 1936, the income actually available for fixed charges was $6,706,000 more than was shown on Exhibit No. 96, and, in addition to that, the Debtor had spent $360,000 additional on initial payments of new equipment. Of course, that came out of cash and did not appear as affecting the amount of income available for interest.

But they had an excess of improvements and betterments of $364,000 over and above what was provided for in Exhibit No. 96, a portion of which was chargeable to operating expense and, therefore, reduced the amount of income available for interest below what it would otherwise have been, instead of being an excess of $6,700,000.

That was the situation at the end of 1936, and therefore the actual operations produced substantially better results than had been anticipated in June, 1935, there was no reason to feel that the June 1935 plan was not going to work out.

In addition to that, the 1935 plan provided that the Reconstruction Finance Corporation would give or supply credit to the extent of $24,000,000, and Exhibit No. 96 showed that $12,000,000 of this money was to be taken advantage of in 1935.

No money has been borrowed from the Reconstruction Finance Corporation on that $12,000,000, and the cash payment on account of the purchase of the equipment which was to come from a Reconstruction Finance Corporation fund has also been paid directly by the corporation or the Debtor out of its income.

Now, we come to 1937, to see what changes have occurred in the situation.

Commissioner Porter: Why go into all that situation Mr. Walker?

The Witness: Merely to disabuse, if that idea is in the

minds of your Honors, the feeling that, as Chairman of this Committee, I have not been following this situation and the Committee has not been following this situation and we have been negligent in our previous conduct in not developing a plan of our own, or reaching the conclusion that the Debtor's plan, which has been introduced in June, 1935, was no longer feasible.

Now, we have the Debtor today with these conditions which have developed since the June hearing with respect to increase in wages. We have also the increase in materials. We have since 1936 the expiration of the surcharges. But, nevertheless, for the year 1937, as we have been going along, the operating results are better than the forecast for 1937 shown in Exhibit No. 96.

I merely wanted to bring that to the attention of the Commission, as Chairman of this Committee, we have been devoting a great deal of time, a great deal of thought, a great deal of study, and have been getting monthly reports from the Debtor, which are carefully examined, and we have gone through their budgets of improvements and betterments and checked each item, and we have been endeavoring to protect the interest of creditors of this Debtor Corporation and at the same time not embarrass them in furnishing the public during the bankruptcy adequate service.

My own personal opinion is that the condition of their property has improved; they have proceeded with improvements and betterments far in excess of what was provided for in Exhibit No. 96, the forecast, and up to the present time that amounts to a very substantial sum in excess of what was anticipated.

Therefore, up until this moment—

Commissioner Porter: What about several months ago when I notified everybody at the hearing that this was going to close it, unless something was done, I mean, of course, subject to being overruled by the Commission.

Mr. Smith: What do you mean by seven months?

Commissioner Porter: Several months ago.

The Witness: Yes, sir, and subsequent to that time we have had the increase in wages of non-operating employees, and the hearings on negotiations which are now going on.

Commissioner Porter: Is not the trouble largely with the application made by Mr. Scandrett, for illustration, the things which he set up, which would apply to every railroad in the United States of America, whether in bankruptcy or

out of it? In other words, those are things that would delay us in every single case before us, if they delay us in the Milwaukee Case, don't you see? Because there are these uncertainties which do exist, and some existed last year, and some different ones exist now, and undoubtedly still different uncertainties will exist 120 days from now, won't they?

The Witness: Yes, sir.

Commissioner Porter: That is the trouble about this whole thing, don't you see? I do not want to argue it. I used to practice law. That is the trouble.

The Witness: In my opinion the defect in Mr. Scandrett's opinion was that he asked for an indefinite postponement.

Commissioner Porter: But the trouble with you right now is, if you will permit me to say it—

The Witness: Yes, sir.

Commissioner Porter: (Continuing.) —You do not tell me definitely. For illustration, I know another railroad in the hearing of which the Director here by my side sat, and where they came in and said, "If you will adjourn this hearing for sixty or ninety days," or whatever it was, "we will be here with another plan," and nobody says that to me this morning.

That is the trouble. 120 days from now we will be just where we are today. So that why should the Commission not get busy itself and put out a plan, if nobody else will? Just tell me that.

Mr. Weiss: May I interrogate Mr. Walker a moment?

The Witness: I would say this, your Honor—

Commissioner Porter: All right. This is all in good spirit. I sometimes get a little too emphatic.

The Witness: I appreciate that, but I would say this, your Honor:

That if I would say to you that our Committee would do this as a positive statement, I would be overstepping my authority in the position that I happen to be in.

Now, I have said to you what I believe, and which I doubt if my saying to you positively would be any stronger assurance, that knowing the members of our Committee as I do, and knowing their views as I do, that in view of the situation which has now developed, that the Debtor says this plan is not feasible, their plan is not feasible; that they have asked for an indefinite postponement, which we were

ready to oppose if the Commissioner had granted it—I can say to you with almost the same positiveness as though the Committee had acted, that the Committee will proceed with its own plan. That is as far as I can go, because I would overstep my authority if I went any further.

Mr. Swaine: I want to correct one statement which has been made, because it has been made several times without qualification.

The Debtor does not admit that the 1935 plan is not a feasible plan. The debtor does not withdraw the 1935 plan. The Debtor's position is that the 1935 plan may become feasible, if the earnings situation is improved commensurate with added expenses; that, in any event the 1935 plan can be made feasible and remain equitable by first providing a financing medium.

Mr. Dick's testimony has indicated that the opinion of the chairman is that under present circumstances it will require displacing the General Mortgage, and the Board has been loathe to make that suggestion, and believes that it should come from the bondholders themselves.

The second modification is—and the chairman was fairly specific in the letter to Mr. Walker on that—that the full cumulative provision with respect to the Fifty Year 5's should be eliminated and the bonds be made cumulative only against income for a limited period of time.

With those two modifications the Debtor believes that the plan is fair and equitable and feasible, even in the light of today's circumstances.

Mr. Burgess: Mr. Scandrett has called my attention to the fact that in my offer of proof I overlooked a consultation which took place in his office in January of this year, at which Mr. Swaine, Mr. Scandrett and Mr. Walker and I were present, at which time Mr. Swaine stated that he thought that certain modifications ultimately would have to be made in this plan.

I stated that the first notice which came to us had been on June 16th, in connection with the offer of proof, and Mr. Scandrett calls my attention to that difference in facts.

In the light of Mr. Walker's testimony, your Honors, I move that the Commissioner reconsider his ruling closing the record, and hold it open for a period of 120 days, during which period any party shall have the right to prepare and at the adjourned hearing present a plan of reorganization; and that permission be extended to the Committee

represented by Mr. Walker to file such plan, inasmuch as we can only do so with the consent of the Commission.

I make that motion.

Mr. Weiss: Before the testimony is closed, I should like to have an opportunity to question Mr. Walker, as long as he has been offered as a witness.

Cross-Examination.

Q. (By Mr. Weiss.) You were present at the last hearing in June 1937?

A. Yes, sir.

Q. You were then advised by the presiding Commissioner that there would be a closing of the hearing today?

A. That is so.

Q. What developed between that date and September 9th, when you first learned of or received notice of the Debtor's petition for an adjournment, that you did not know before?

A. The increase in the wages of non-operating employees and the application of the operating employees for a 20 per cent increase.

Q. When did you first learn that?

A. I first learned it sometime around—I could not say exactly when, but in the summertime.

Mr. Burgess: It was after August 1st.

The Witness: That 5 cents had been granted to the non-operating employees.

Q. (By Mr. Weiss.) What practical steps did your committee take from the time of the announcement at the hearing by the Commission, that the hearings would be closed today, to formulate a new plan or modify the existing plan?

A. At the time that the Commissioner made the announcement at the previous hearing, the actual operating results were running so far ahead of the forecast that there was every reason to believe that if that stand-by plan, which carried along for a minimum period of five years and a maximum of ten years, would work out effectually.

Q. You used the term "stand-by plan".

A. Yes, sir.

Q. Do I understand that to be tantamount to a stop-gap plan?

A. No, a stand-by plan.

Q. What is the difference between a "stand-by plan" and a regular plan?

A. There is a good deal of difference between that and a stand-by plan, because this stand-by plan provided that during a certain period of time a portion of the interest on the General Mortgage bonds would be fixed and a portion of the interest would be contingent, and all of the interest on the Fives of 1975 was to remain contingent.

Q. When you used the words "stand-by plan", you did not mean to intimate, then, that this was only a temporary plan which was not seriously to be submitted and acted upon by the Commission, did you?

A. No, I mean it is a plan that in the best judgment of those who worked on the plan at that time would give the opportunity to demonstrate during this so-called stand-by period the earning capacity of this railroad instead of relying at that time upon a permanent and final capital structure that was based purely upon forecasts in the depth of the traffic depression, practically, of 1935.

Q. The fact of the matter is that you permitted matters to drift from the 16th of June until today in the hope that the Commission might change its mind about the closing of the hearing?

A. That is not a fact at all. The fact of the matter is that we followed the situation closely, and as soon as we were able to determine the effects of this wage increase upon the earnings of the Debtor, and we saw then as the Debtor has now stated, that instead of 1937 having a favorable operating result as compared to Exhibit No. 96, which for 1937 showed $3,147,000, it would have to be reduced at least to $2,000,000, without taking into consideration any increase in the operating employees.

And that for 1938 it would fall behind with an increase only to the non-operating employees—it would fall behind Exhibit No. 96, which showed under the working of the plan $1,631,000.

Q. In other words, factors developed which indicated to you shortly after the 16th of June that there would have to be a modification?

A. Not shortly after, no.

Q. Then what did you do in the interim between the 16th of June and when it first occurred to you that there had to be a new plan?

A. Between the 16th of June and the time when these additional expenses became apparent, there was every evidence to show that the plan was feasible for the purposes for which it was originally put in in advance, and that unless there were these increases, which subsequently developed, that the plan was a feasible plan and the actual earnings during the so-called stand-by period of between five and ten years would so demonstrate.

Q. Now, in June, 1937 you did know that the fixed charges under this plan were something over $7,000,000?

Commissioner Porter: Let us not prolong this.

Mr. Weiss: I simply want to indicate that the Committee did nothing, and there was no serious attempt——

Mr. Swaine: I can say positively to my knowledge that that is not so.

Mr. Weiss: There has been no serious attempt made by the Committee really to get down to brass tacks and to come to the Commission with a plan.

Mr. Swaine: We have been working on this problem to the best of our ability. We may lack ability, but we certainly have been working.

Mr. Abrams: May I ask two questions only?

Commissioner Porter: No, I think not. Let us not prolong this. Is there anything further?

The Witness: No, sir.

Mr. Clay: May I call one thing to his attention which I think Mr. Walker made a mistake on?

Commissioner Porter: No, I do not think so, Mr. Clay. Let us bring this to a close.

Is there anything further?

Mr. Burgess: That is all.

(Witness excused.)

Commissioner Porter: The motion made by Mr. Burgess is overruled, and my ruling will stand as made. There is no assurance here definitely, as in other cases, that if this case is continued that other and different plans will be presented here with testimony, bona fide plans with testimony to back them up.

Therefore, my ruling stands.

Mr. Burgess: I ask for an opportunity to file a petition and brief thereon with the Commission within twenty days, to review the ruling of the Commissioner.

Commissioner Porter: That is all right, sir.

Gentlemen, how long do you want in which to file briefs in this matter?

Mr. Smith: May we not perfect this appeal, if you may term it that, and have a ruling from the Commission before that?

Commissioner Porter: You had better be working on briefs along during that time. That is my suggestion.

Mr. Smith: Your Honor has given us twenty days only to file briefs in this matter.

Mr. Bagon: Sixty days.

Mr. Abrams: I think thirty days.

Commissioner Porter: In view of this motion, and the fact that the Commission might overrule my ruling, I will fix the brief date as within sixty days from this date, at which time all briefs will be filed.

Is there anything further?

Mr. Smith: If your Honor please, may I say a word about that?

Commissioner Porter: Yes, sir.

Mr. Smith: We have got to write a brief on the question as to whether or not these hearings should be adjourned without an opportunity to present a plan for the Commission, and we will be busy on that in part of the time which the Commissioner his allowed. You are allowing us a very short time after the filing of that brief to start work and prepare the second brief. We cannot prepare both of these briefs at once.

Commissioner Porter: The ruling will stand as made. I am set today.

Now, is there anything from anybody else?

Mr. Abrams: Will your Honor in the brief expect recommendations and suggestions as to modification of the plan?

Commissioner Porter: Yes, that is what I understand they are for, among other things. Of course, every suggestion must be based upon facts developed here of record. The Commission cannot go beyond this record, but, of course, briefs are for the purpose of helping the Commission in either approving this plan or modifying it or bringing in a new one on its part, or dismissing it, as an alternative.

I believe that is all, gentlemen. We will stand adjourned then.

(Whereupon, at 12:45 o'clock p. m. the hearing was closed.)

3727 ORDER.

At a Session of the Interstate Commerce Commission, Division 4, held at its office in Washington, D. C., on the 24th day of September, A. D. 1937.

(Caption—10882)

The Group of Institutional Investors, holders of securities of Chicago, Milwaukee, St. Paul and Pacific Railroad Company, an intervener, having presented a petition, filed herein on September 24, 1937, requesting that the hearings in this proceeding be reopened and a further hearing be assigned on or about January 18, 1938, for the purpose of the submission by said group of a plan of reorganization for the debtor; and

It appearing, That the Group of Institutional Investors, by resolution adopted at a meeting held September 23, 1937, is committed to prepare and present such plan, with evidence in support thereof, at the further hearing sought in the petition;

It is ordered, That the hearing herein be reopened and the proceeding be and is assigned for further public hearing before Commissioner Porter and Director Sweet at the office of the Commission in the City of Washington, D. C., at 10:00 a. m., February 1, 1938, for the purpose of presentation of such plan of reorganization and evidence in support of and in opposition thereto, and for the presentation of any other plans of reorganization which properly may be received and evidence relative thereto; and

It is further ordered, That any and every plan to be presented at such hearing shall be tendered to the Commission for filing on or before January 10, 1938, and shall be forwarded on or before that date by parties sponsoring it, together with memoranda of the testimony and copies of exhibits to be offered in support thereof, to all parties in the proceeding before the Commission who have heretofore participated in hearings on the debtor's plan of reorganization herein.

By the Commission, division 4.

W. P. Bartel,
Secretary.

(Seal)

4492 ORDER.

At a Session of the Interstate Commerce Commission, Division 4, held at its office in Washington, D. C., on the 11th day of January, A. D., 1938.

* * (Caption—10882) * *

Upon consideration of the record in the above-entitled proceeding and petition filed by Victor Greiff, for leave to intervene herein;

It Is Ordered, That the said Victor Greiff, be, and he is hereby, permitted to intervene and be treated as a party hereto.

It is further ordered, That a copy of the intervening petition and of this order be served upon each of the parties to this proceeding; and that a copy of this order be served upon all other interested parties.

By the Commission, Division 4.

(Signed) W. P. Bartel,
Secretary.

(Seal)

2722 BEFORE THE INTERSTATE COMMERCE COMMISSION.

* * (Caption—10882) * *

Hearing Room "A", I. C. C. Building,
Washington, D. C.,
Tuesday, February 1, 1938.

The above-entitled matter came on for hearing, pursuant to notice, at 10 o'clock a. m.

Before:

Director Oliver E. Sweet.
Examiner M. S. Jameson.

Appearances:

The same as heretofore noted.

Additional Appearances:

Albert K. Orschel, 11 S. LaSalle St., Chicago, Ill., appearing for Protective Committee for Holders of Preferred Stock.

John B. Marsh, 20 Exchange Place, New York City, appearing for City Bank Farmers Trust Company as Trustee under First Mortgage, and as Trustee under Consolidated Mortgage of Milwaukee & Northern Railroad Company.

Kenneth F. Burgess, Douglas F. Smith, Paul V. Harper, George Ragland, Jr., and D. R. Thomas,
2723 Group of Institutional Investors, 11 South La Salle St., Chicago, Ill.

Robert M. Becket, of Wright, Gordon, Zachary & Parlin, 63 Wall St., New York, N. Y., appearing for Chemical Bank & Trust Company, Trustee under the First and Refunding Mortgage.

Guido Panteleoni, Jr., 20 Pine St., New York, N. Y., appearing for William Church Osborn, Intervener.

William V. Hodges, 20 Pine Street, New York, N. Y., appearing for William Church Osborn, Intervener.

Sanford H. E. Freund and John A. Hill, 55 Wall St., New York City, appearing for The National City Bank of New York and W. W. Hoffman, Trustees of Adjustment Mortgage of C. M. St. P. & P.

M'Cready Sykes, 45 Wall Street, New York, N. Y., appearing for United States Trust Company of New York as Trustee under General Mortgage Chicago, Milwaukee and St. Paul Second Mortgage.

Daniel Willard, Jr., Transportation Bldg., Washington, D. C., appearing for The Railroad Credit Corporation.

Malcolm Mecartney, No. 1 North LaSalle Street, Chicago, Ill., appearing for J. E. Harvey, Chicago, Ill.

Samuel W. McIntosh, National Press Bldg., Washington, D. C., appearing for J. E. Harvey, Chicago, Ill.

Julius Weiss, 122 East 42nd St., New York, N. Y., appearing for Independent Bondholders Committee.

2726 Proceedings.

Director Sweet: There is set for further hearing this morning the proceeding in Docket No. 10882, the Chicago, Milwaukee, St. Paul & Pacific Railroad Company reorganization.

After the hearings were closed on the 20th of September, 1937, the Commission on the 24th day of last September entered its order reopening the proceedings for further hearing at this time and place.

A provision contained in that order provided that any and every plan to be presented at this hearing should be tendered to the Commission and filed on or before January 10, 1938, etc.

On the 10th of January, 1938, a plan of reorganization was presented by a group of institutional investors, holders of Chicago, Milwaukee, St. Paul & Pacific securities. Later a document was filed, which was designated as "Modified Plan of Reorganization" amending the plan filed January 10, 1938.

The purpose of this hearing is to receive evidence in support of the plan presented and with reference to any other plans that have been heretofore filed.

It is not necessary to take appearances of those who are parties in the proceedings. If there are petitions for leave to intervene, they may be considered now.

2727 Mr. Oliver: I should like to present, after the noon recess, a petition to intervene on behalf of a group of interveners.

Director Sweet: Have you served a copy?

Mr. Oliver: I will be prepared to serve copies this afternoon.

Director Sweet: We will take it up when you present it.

Mr. Orschel: I would like to present a petition for Committee formed for the protection of the preferred stockholders. The original petition has previously been sent down and I have the necessary copies here.

Director Sweet: Is that petition for leave to intervene?

Mr. Orschel: Yes.

Director Sweet: On behalf of the preferred stockholders?

Mr. Orschel: On behalf of a committee formed for the protection of the preferred stockholders.

Director Sweet: Has that committee been authorized?

Mr. Orschel: Yes, it has been authorized. Authority was given on November 22nd, I believe.

Director Sweet: You may distribute copies, and if there is no objection, it will be allowed.

Mr. Hodges: We filed a petition to intervene on
2728 behalf of William Church Osborn. It was sent by mail and is on file. I have not been advised what disposition has been made. Copies were mailed.

Director Sweet: Do you represent anyone here besides yourself?

Mr. Hodges: Mr. William Church Osborn, that is all.

Director Sweet: Does Mr. Osborn represent anybody else?

Mr. Hodges: Only himself and his family.

Director Sweet: Is he a creditor?

Mr. Hodges: He is a holder and represents over a million dollars of 5's and 75's.

Director Sweet: He has not invited other people to join with him?

Mr. Hodges: No. He intends to make application in due season, if there is such a thing as a due season from now on.

Director Sweet: He is not acting in any sense as a protective committee?

Mr. Hodges: No. He is not acting as a committee.

Director Sweet: You have circulated copies of the petition?

Mr. Hodges: Yes; and mailed to the parties.

Director Sweet: Is there any objection to this intervention?

2729 (No response.)

Director Sweet: It may be granted.

Mr. McIntosh: Mr. Director, I am appearing here at the request of Mr. Malcolm Mecartney of Chicago from whom I have received a telegram stating that he was unavoidably detained and could not be present here. I have entered an appearance for him and for myself on behalf of J. E. Harvey of Chicago, who owns 5,000 of the St. Paul Railroad 5's—1975, and several other individual holders whose names I do not now have, who desire through Mr. Mecartney to present petition to intervene. A signed petition will be prepared and forwarded to the Commission by tomorrow. I should like to have leave of the Commission to file and serve the necessary copies.

Director Sweet: When you have it, you may present it.

On the 15th of January the Commission received a document entitled "Plan of Reorganization for Chicago, Milwaukee, St. Paul & Pacific Railway Company" pre-

sented by an independent committee for protection of Chicago, Milwaukee, St. Paul & Pacific Railroad Company bondholders. One copy was received by the Commission. This purports to be a plan of reorganization which was filed too late under the order of September 24, 1937.

2730 I am authorized by the Division to say that this plan may not be presented as a plan at this hearing.

Mr. Weiss: Will that plan be considered filed with the Commission, however?

Director Sweet: It is not a plan which may be presented at this hearing.

Mr. Weiss: In other words, no evidence in support of it may be offered?

Director Sweet: It is not a plan before the Commission.

Mr. Weiss: May I make application to the Commission to consider it as a filed plan?

Director Sweet: It is not in our record. It has not been filed as a plan.

Mr. Weiss: What steps must be taken to bring it before the Commission as a plan and have it considered?

Director Sweet: I am not advised. It came too late under the Commission's order.

Mr. Weiss: Do I understand January 10th was the final date for filing?

Director Sweet: Yes.

Mr. Weiss: I believe it was filed pretty close to the 10th.

Director Sweet: It was filed on the 15th of January.

The date fixed for filing plans before this

2731 hearing was January 10th. One copy was received.

Of course, we cannot very well act on a single copy of the plan. Additional copies have not been furnished.

Mr. Weiss: Thirty copies were filed.

Director Sweet: They came later. They arrived two or three days ago. Are there any other interventions?

(No response.)

Director Sweet: On the 31st of January, 1938, the Commission received on behalf of Victor Grief, an intervener, a memorandum of suggestions on reorganization, and requested that it be read into the record at this time. Mr. Grief is an intervener and may participate in the proceedings, but this is not the time for acting upon plans. Unless Mr. Grief is prepared to testify as a witness here, his so-called memorandum may not be considered at this time.

Who appears on behalf of the proponents of the plan filed on the 10th of January?

Mr. Burgess: Mr. Smith, Mr. Harper, Mr. Ragland, Mr. Thomas and I appear.

Director Sweet: Are you ready to proceed?

Mr. Burgess: Yes.

Director Sweet: You may do so.

Mr. Burgess: We requested the debtor to prepare
2732 and submit certain additional evidence, largely in the nature of bringing down to date the previous evidence presented by the debtor. I understand Mr. Oliphant of the accounting department of the road is present and is ready now to comply with that request.

C. E. OLIPHANT, was sworn and testified as follows:

Direct Examination.

Q. (By Mr. Burgess.) What is your occupation, Mr. Oliphant?

A. Chief Statistician for the trustees of the property of the Chicago, Milwaukee, St. Paul and Pacific Railroad Company.

Q. Where do you reside?

A. In Chicago.

Q. How long have you been connected with the Milwaukee Railroad?

A. Very close to twenty years.

Q. In what department?

A. Originally in the valuation department for a short time; then in my present position, but with different titles throughout the period.

Q. In your present position, do you have access to records of the Milwaukee Railroad?

A. Yes, sir.

2733 Q. Was the request that I made of Scandrett, one of the trustees of the Milwaukee Railroad, under date of January 28, 1938, referred to you?

A. Yes, sir.

Q. Have you prepared information to comply with that request?

A. In part, yes, sir.

Q. Is it in the form of exhibits and material that you have prepared?

A. Yes, sir.

Q. Will you then, Mr. Oliphant, please proceed in your own way to present any statistical form of evidence requested in my letter addressed to Mr. Scandrett, in so far as it has been prepared by you.

A. Yes, sir. The first exhibit relates to the Milwaukee & Northern.

Mr. Burgess: I will offer that as Exhibit No. 156.

(The document referred to was received in evidence and marked EXHIBIT NO. 156, witness Oliphant.)

Q. (By Mr. Burgess.) The document that has been marked Exhibit No. 156 was prepared to comply with the first request that I made?

A. Yes, sir.

Q. It presents a further analysis of the allocation of earnings of the two Milwaukee & Northern mortgage
2734 districts north and south of Green Bay, Wisconsin, for the year 1936, does it?

A. Yes, sir.

Q. Have you anything further you wish to say about this exhibit?

A. As an introduction, I have a brief statement.

All of the statements of revenues, expenses and income for the Milwaukee & Northern Lines so far in the record in this proceeding are for the Milwaukee & Northern Lines as a whole. The Milwaukee & Northern First Mortgage is a first lien on the lines south of Green Bay and the Consolidated Mortgage is a first lien on the lines north of Green Bay. It is also a second lien on the lines south of Green Bay.

Under the Debtor's Plan of Reorganization of July 1, 1935, the bonds outstanding under these two mortgages were accorded equal treatment and there was no occasion for considering the earnings of the different parts of the lines under the first liens of the two mortgages. With the plan of reorganization now presented by the Group of Institutional Investors, wherein the bonds under these two mortgages are accorded different treatment, the earnings of the parts of these lines under the first liens of these mortgages may be of interest.

We have in the past few weeks been able to set up a fairly substantial estimate of the separation of Mil-
2735 waukee & Northern earnings for 1936, as shown in Exhibit No. 141, as between the lines subject to the first liens of the two mortgages and I have an exhibit showing this separation which I should like to submit.

That has reference to document identified as Exhibit No. 156.

Q. Is there anything further you wish to say about that document?

A. This is an income statement for the Milwaukee & Northern lines for the year 1936 with estimated separation between lines subject to the first liens of the first mortgage and of the consolidated mortgage; that is, south and north of Green Bay.

The first column of figures are identical with those put in as Exhibit No. 141. This exhibit, by the way, consists of four sheets. The first is tabular statement and the three following sheets are memoranda of the method by which the estimate was made.

The second column of figures shows the estimated earnings of the lines south of Green Bay or the lines subject to the first lien of first mortgage and the last column shows the earnings of the lines north of Green Bay or the lines subject to the lien of the consolidated mortgage.

The income available for interest for the lines as a whole, and as shown by Exhibit No. 141, was $495,182.
2736 This statement shows assignment to the lines south of Green Bay of $411,633 and to the lines north of Green Bay $83,549. After interest on the bonds outstanding, the lines south of Green Bay had a net income of $316,368, after interest on the first mortgage bonds. The lines north of Green Bay, after interest charges on the consolidated mortgage, which is also a second lien on the lines south of Green Bay, had a deficit of $144,691.

On the attached sheet is a brief statement of how this estimate was made up as between the lines north and south of Green Bay.

The freight revenues are practically actual—in fact was actually a separation which was made by our freight auditor, with the revenues assigned to the Milwaukee & Northern in Exhibit 141, upon the basis of a mileage prorate with a minimum of 25 per cent to the line having the short haul. Is it necessary for me to read this formula?

Q. No. The exhibit is self-explanatory otherwise, is it not?

A. Yes. I would like to call attention to the fact that the greatest amount of estimating was in connection with maintenance of way. The maintenance of way division between north and south of Green Bay was an out and out

estimate by our Assistant Chief Engineer. All other
2737 expenses were apportioned upon same basis of statistics, as in equipment repairs, etc., separated upon the basis of locomotive car miles, etc.

Q. Mr. Oliphant, in order that the record may be entirely clear, while this was requested in letter of January 28, 1938, to which I have referred, was requested previously orally, was it not?

A. Yes, sir.

Q. That is true of all of these exhibits that you are now presenting. In other words, they have not just been presented in the last day or two?

A. That is true. We have been working probably close to a month on the separation of the Milwaukee & Northern north and south of Green Bay.

Q. Have you prepared reproduction of Exhibit No. 139 entitled "Revenues, Expenses and Net Income of the Terre Haute Lines" for the year 1936?

A. Yes, sir.

Q. So as to show the earnings when company material is computed on the cost of service basis, together with data and testimony supporting the modification?

A. Yes, sir.

Q. Have you prepared that in the form of an exhibit?

A. Yes, sir.

Mr. Burgess: May that be marked Exhibit 157 and distributed?

2738 (The document referred to was received in evidence and marked "EXHIBIT NO. 157, witness Oliphant.")

Q. (By Mr. Burgess.) What have you to say about this document marked Exhibit No. 157?

A. Statements of revenues, expenses and income of the Terre Haute Lines so far submitted in this proceeding—Exhibit No. 90 for 1933 and 1934 and Exhibit No. 139 for 1936—were set up in a manner to show the worth or value of the Terre Haute to the Milwaukee system, that is, the Terre Haute was considered somewhat as a separate road. It was allowed revenue at tariff rates for its haul of Milwaukee Company coal and other company material and was charged tariff rates for the haul of its company material over other system lines. In the interline use of system freight cars the Terre Haute was credited for its cars on other system lines and debited for Milwaukee cars on Terre Haute lines at standard per diem rates.

It was thought that this was a clear and simple way of showing the value of the Terre Haute lines to the Milwaukee system for, if the Terre Haute were not allowed revenue at tariff rates for the haul of Milwaukee coal and other company material, the difference between such an allowance and any lesser allowance would have to be brought into the picture of the worth of the Terre
2739 Haute as a savings of the Milwaukee, because without the Terre Haute, the Milwaukee would have to pay equivalent freight charges to foreign roads to obtain its company coal and other company material. During the 12 months next preceding the leasing of the Terre Haute, the Milwaukee paid $2,970,425 in freight charges to foreign roads, including the Terre Haute, for the haul of its Company coal from sources which, after the leasing, were replaced by mines on the Terre Haute. The treatment of system freight car rentals was necessary to be consistent in this matter.

Exhibits Nos. 90 and 139 were not designed nor intended to reflect a division of system earnings assignable to the Terre Haute mortgages or to the leasehold, as our formula for this purpose, and as used for this purpose in statements of revenues, expenses and income of the Milwaukee & Northern, the Gary and First and Refunding Mortgage lines, also in the record in this proceeding, assumes that all mortgages lines are operated as parts of the system, and has as its basic principle the allocation between different lines of debits and credits on a cost basis or a cost of service basis. Haul of company material is charged and credited on the basis of estimated out-of-pocket cost of the haul and equipment rents for system equipment are computed at interest on the estimated cost of reproduction less depreciation of the equipment
2740 used—proper credit being given to the subordinate lines for the equipment considered to be under the liens of their mortgages.

To convert the showings of the worth or value of the Terre Haute to the Milwaukee system, Exhibits Nos. 90 and 139, to a segregation of earnings basis, to conform with our general formula and to be comparable with the showings made for the Milwaukee & Northern, the Gary and the 1st and Refunding Mortgage lines, it is necessary to deduct from the Terre Haute income the revenue allowance and charge at tariff rates for the haul of company coal and other material and add back an allowance of an

estimated out-of-pocket cost of the haul, and to deduct the system freight car rentals on the standard per diem basis and add back interest rental on reproduction cost of the cars less depreciation, together with necessary adjustments in car repair and depreciation charges.

This has been done for the year 1936—as related to Exhibit No. 139—and I have an exhibit in the matter which I should like to submit.

That is the document that has been identified as No. 157.

Q. That document contains figures that are correct to the best of your knowledge and belief, does it?

A. It does, yes, sir.

2741 Q. Have you anything further to say that will be necessary to make it understood?

A. This exhibit consists of two pages. The first page starts off with the income available for interest charges, as shown on Exhibit No. 139. That is, the income of transportation of all company material at tariff rates and rental for system freight cars on standard per diem. Adjustments then follow of deducting a revenue allowance at tariff rates for the hauling of Milwaukee Company material, and adding back allowance at out-of-pocket cost for Terre Haute haul of Milwaukee Company material. That is Item 2(b). This is the last item I have referred to, and it is further supported by page 2 of the exhibit, which develops the out-of-pocket cost for haul of freight, the Terre Haute haul of Milwaukee Company coal and other company material.

From there it is a logical development down to income available for interest charges on a cost of service basis, Item 3, which is $2,040,187, as against the corresponding figure in Exhibit No. 139 of $2,990,126.

There are some further reductions of rent and interest on equipment trusts, which has been assigned to the Terre Haute, leaving a net income on a cost of service basis after rental and equipment interest of $875,327.

2742 Q. My next request had to do with the segregation of earnings for general mortgage lines. Have you prepared an exhibit in reference to that matter?

A. I have.

Mr. Burgess: May that be marked Exhibit No. 158?

(The document referred to was received in evidence and marked "EXHIBIT NO. 158, witness Oliphant.")

Q. (By Mr. Burgess.) Referring to this document, consisting of one sheet, which has been marked Exhibit No.

158, what have you to say regarding that in an explanatory way?

A. So far in this proceeding no statement has been made of the income of General Mortgage lines available for interest on equipment obligations and funded debt.

Statements in this respect have, however, been made, and included in the record, for all other mortgage lines for the year 1936, and with the system figure of income available for interest on equipment obligations and funded debt, in 1936, the similar figure for the General Mortgage lines for this year can be derived by a process of deduction.

I have an exhibit in this matter entitled, "Estimated Income of General Mortgage Lines Available for Interest on Equipment Trusts and other Funded Debt, Year 1936", which I should like to submit.

Q. That has been marked Exhibit No. 158?

2743 A. Yes, sir.

Q. Does that exhibit require any explanation on your part?

A. It might help to describe it briefly. We start off with the income of the System available for fixed charges as reported. That is, to the Interstate Commerce Commission. We deduct certain charges other than interest on equipment obligations and funded debt as follows. That is mainly interest on funded debt. Also rent for leased roads other than interest on C. T. H. & S. E. bonds, reaching a figure of income of System available for interest on equipment obligations and funded debt. From that figure we deduct the income available for interest on funded debt of lines subject to liens or mortgages other than the General Mortgage.

In Item 1 the C. T. H. & S. E. showing is that of Exhibit No. 139 adjusted to a cost of service basis and a reference is made to an exhibit blank, which should be Exhibit 157.

With that adjustment in the Terre Haute to a cost of service basis and adding the Milwaukee & Northern and Gary and the First and Refunding Lines as taken from the respective exhibits in this proceeding, all on a cost of service basis, we reach a total for lines other than the General Mortgage lines, and deducting that total, reach an income available for interest on equipment obligations and

2744 funded debt of $8,716,847.

Q. The next request that was contained in our letter was on account of a misunderstanding as to what was already in the record and has been withdrawn.

A. Yes, I so understand.

Q. Have you a copy of the indenture and lease agreement covering equipment trusts, Series R?

(At this point there was a short discussion off the record.)

Mr. Burgess: May we offer Exhibit No. 159?

(The document referred to was received in evidence and marked "EXHIBIT NO. 159, witness Oliphant.")

Q. (By Mr. Burgess.) Describe Exhibit No. 159.

A. This is an agreement in respect to an equipment trust, Series R, between—

Q. Bearing what date?

A. Bearing date August 1, 1937.

Q. I think that is sufficiently identified. It covers railroad equipment trust, Series R, as of the date mentioned, and was executed by the trustees.

The next request made was for annual reports to stockholders for the years 1921 to 1927, inclusive. Are those available?

A. Yes.

Mr. Burgess: Annual report to stockholders for
2745 the year 1921, being the 57th annual report, I will ask to have marked Exhibit No. 160.

(The document referred to was received in evidence and marked "EXHIBIT NO. 160, witness Oliphant.")

Mr. Burgess: For the year 1922, the 58th annual report of the Chicago, Milwaukee & St. Paul Railway Company to stockholders I will ask to have marked Exhibit No. 161.

(The document referred to was received in evidence and marked "EXHIBIT NO. 161, witness Oliphant.")

Mr. Burgess: For the year 1923, the 59th annual report of the Chicago, Milwaukee & St. Paul Railway Company, I will ask to have marked Exhibit No. 162.

(The document referred to was received in evidence and marked "EXHIBIT NO. 162, witness Oliphant.")

Mr. Burgess: For the year 1924, the 60th annual report of the Chicago, Milwaukee & St. Paul Railway Company, I will ask to have marked Exhibit No. 163.

(The document referred to was received in evidence and marked "EXHIBIT NO. 163, witness Oliphant.")

Mr. Burgess: And for the year 1925, being statistics
of operation of the Chicago, Milwaukee & St. Paul
2746 Railway Company, by H. E. Byram, Mark W. Potter

and Edward J. Brundage, Receivers, I will ask to have marked Exhibit No. 164.

(The document referred to was received in evidence and marked "EXHIBIT NO. 164, witness Oliphant.")

Mr. Burgess: For the year 1926, statistics of operation of the Chicago, Milwaukee & St. Paul Railway, by the same receivers, Exhibit No. 165.

(The document referred to was received in evidence and marked "EXHIBIT NO. 165, witness Oliphant.")

Mr. Burgess: For the year 1927, statistics of operation of the Chicago, Milwaukee & St. Paul Railway, same receivers, Exhibit No. 166.

(The document referred to was marked "EXHIBIT NO. 166, witness Oliphant", and received in evidence.)

Mr. Burgess: Have you income statement of the Chicago, Milwaukee, St. Paul & Pacific Railroad Company for the year 1937?

The Witness: Yes, sir.

Mr. Burgess: I will ask to have that marked as Exhibit No. 167.

(The document referred to was marked "EXHIBIT NO. 167, witness Oliphant", and received in evidence.)

2747 Q. (By Mr. Burgess.) Are the statistics contained in this document marked Exhibit No. 167 taken from the books and records of Debtor and are they correct to the best of your knowledge and belief?

A. Yes, sir, they are.

Q. Exhibit No. 167 also contains summarized balance sheet as of December 31, 1937?

A. That is correct. The first sheet is the balance sheet.

Q. Have you prepared a statement bringing down to the most recent date practical the data shown on Exhibit 95 entitled "Estimated Mortgage Replacement Value of C. T. H. & S. E. Equipment Vacant as of June 30, 1935"?

A. This was done in our accounting department. It was not done under my direction.

Q. Is it here and available?

A. Yes, sir.

Mr. Burgess: Please have that distributed and I will ask to have it marked as Exhibit No. 168.

(The document referred to was marked "EXHIBIT NO. 168, witness Oliphant", and received in evidence.)

Q. (By Mr. Burgess.) Have you with you statement

of loans received from Railroad Credit Corporation and balances due on such loans as of December 31, 1937?

A. Yes, sir, that information is here.

2748 Mr. Burgess: Please have that distributed and I will ask to have it marked Exhibit No. 169.

(The document referred to was marked "EXHIBIT NO. 169, witness Oliphant", and was received in evidence.)

Mr. Burgess: Has a statement been prepared, Mr. Oliphant, showing general creditors as of September 30, 1937, who have made claims against the Chicago, Milwaukee, St. Paul and Pacific Railroad Company for the period prior to June 30, 1935, that are not entitled to priority under the provisions of the Section 77?

A. Yes, sir.

Mr. Burgess: Please have that distributed and I will ask to have it marked Exhibit No. 170.

(The document referred to was marked "EXHIBIT NO. 170, witness Oliphant", and received in evidence.)

Q. (By Mr. Burgess.) Has a statement been prepared showing the present status of the collateral pledged under various of collateralized loans?

A. Yes, sir.

Mr. Burgess: Please have that distributed, and I will ask to have it marked Exhibit No. 171.

(The document referred to was marked "EXHIBIT NO. 171, witness Oliphant", and was received in evidence.)

2749 Q. (By Mr. Burgess.) Exhibit No. 171 is a single sheet entitled "Statement of Collateral and Cash held as of December 31, 1937, by United States Trust Company of New York, as trustee under the Chicago, Milwaukee & St. Paul Railway Company general mortgage dated May 1, 1889", is that correct?

A. Yes, sir.

Q. Exhibit No. 172 is entitled "Collateral pledged as of December 31, 1937" for Reconstruction Finance Corporation Loan, the Railroad Credit Corporation loan, and C. T. H. & S. E. Railway Company First and Refunding Mortgage?

A. Yes, sir.

Q. Has that been distributed?

A. Yes, sir.

Mr. Burgess: I will ask to have that marked Exhibit No. 172.

(The document referred to was marked "EXHIBIT NO. 172, witness Oliphant", and was received in evidence.)

Q. (By Mr. Burgess.) The Chemical Bank and Trust Company has asked that a statement of the collateral and cash held by it as trustee under the First and Refunding Mortgage be presented. Have you prepared a statement on that?

A. That statement has been prepared, yes, sir.

2750 Mr. Burgess: May that be marked Exhibit No. 173?

(The document referred to was marked "EXHIBIT NO. 173, witness Oliphant" and was received in evidence.)

Mr. Burgess: Referring to these various documents that have been marked Exhibits 156 to 173, inclusive, we ask that they be received in evidence.

Director Sweet: My understanding at this hearing is that all exhibits are received unless objected to and the objection sustained.

Q. (By Mr. Burgess.) Does that complete the material that was requested of you, Mr. Oliphant?

A. Yes, that completes the material requested of me.

Mr. Burgess: I have no further questions.

Director Sweet: Any cross-examination?

Mr. Marsh: Mr. Director, I represent the City Bank Farmers Trust Company as Trustee under the two Milwaukee & Northern mortgages. Our situation is a little bit unusual. In the Debtor's plan as originally filed, those two mortgages were to be left undisturbed and extended, and, accordingly, during the early part of these proceedings, and in fact until the present hearing, there has been no suggestion that these mortgages would be disturbed. It was only when we received copy of the plan of the institutional group that we were faced with the suggestion

that the first mortgage should be refunded in the new
2751 first mortgage bonds and the consolidated mortgage of the Milwaukee & Northern should be refunded partly in those bonds and partly in junior securities. As soon as I received that plan I endeavored to secure the data on which that provision was based. Mr. Burgess was kind enough to say that the data was being prepared by the Debtor's or the trustee's accountants, but would probably not be ready before hearing. I also wrote to Mr. Dynes and received the same reply from him. So I have never

seen these exhibits relating to the Milwaukee & Northern properties until they were introduced in evidence today. They raise some very important questions in respect to those mortgages, and I think we should have time to study the exhibits and confer with the officials who prepared them before being required to cross-examine.

Director Sweet: You are not prepared to cross-examine now?

Mr. Marsh: No, sir.

Director Sweet: You will have to complete your cross-examination before the hearing is closed.

Mr. Marsh: There is no possible way to prepare ourselves and make a thorough cross-examination on the exhibits which we have never seen until the beginning of the hearing.

Director Sweet: It is the Commission's desire to
2752 close the hearings at this session, if possible.

Mr. Marsh: Would there be any possibility of an order being made which would reserve the right to introduce after the close of the hearing exhibits supplementing or correcting—

Director Sweet: Those are matters of agreement between counsel in the first instance. You may endeavor to agree upon any plan of that sort you have with counsel and let us know about it.

Mr. Marsh: I would like to ask one or two questions.

Director Sweet: Proceed.

Cross-Examination.

Q. (By Mr. Marsh.) On Exhibit 156, the item of net income after interest is shown as a net figure of $171,000-odd, is it not?

A. Yes, sir, for the lines as a whole.

Q. Then it shows the net income available after interest on the first line first mortgage properties, of $316,000?

A. Yes, sir.

Q. It shows a deficit on the consolidated mortgage property of $144,000?

Q. It is a fact, is it not, that the consolidated mortgage is a second lien on the first mortgage property?

A. Yes, sir.

2753 Q. So that those bonds are entitled to credit for the excess earning of the first mortgage?

A. I think that is true.

Q. So that there is not an actual deficit on the consolidated mortgage?

A. No; it is on the lines on which the consolidated is a first lien.

Q. I notice an item of equipment rents here; charges for private cars, mileage payments, foreign cars, per diem and system equipment, interest rental. Can you tell me how the item "system equipment—interest rental" was computed?

A. It is interest upon the system equipment, equipment used on the Milwaukee & Northern lines. It is computed upon the basis of interest at 5 per cent upon the estimated reproduction cost new of the equipment less depreciation.

Q. How did you arrive at the 5 per cent?

A. It was just arbitrarily taken at 5 per cent rather than 4 or 6.

Q. Is the system as a whole earning 5 per cent on its depreciated value?

A. Not upon its investment value, no, sir.

Q. I mean on the value that you took as a basis for computation of this interest charge?

A. Just upon the equipment involved in this case?

2754 Q. Yes.

A. I would not know.

Q. You have stated that you took the depreciated value of the equipment used on this part of the system and charged interest at 5 per cent on that value.

A. Yes, sir.

Q. Now, if you take the value of the system as a whole on a comparable basis, is it earning 5 per cent?

A. Why, no. The system has a certain earning in 1936 of some $10,000,000.

Q. That is not 5 per cent?

A. On the value of the equipment?

Q. On the value of the system as a whole.

A. On the value of the property as a whole?

Q. Yes.

A. No. I would say it was not 5 per cent on the value of the property as a whole.

Q. What led you to take 5 per cent as the proper rate, then, for this part of the system?

A. That seemed to us to be a fair rental arrangement

between the Milwaukee & Northern lines and the balance of the system.

Q. Are there any foreign line arrangements by which you pay rental on that basis?

A. No. I know of no foreign line arrangement.

Q. Are there any equipment trusts on which you
2755 pay as much as 5 per cent on a value computed in that manner?

A. I do not know whether we have one at 5 per cent or not. We have some—

Q. In making this charge for system equipment, have you made any allowance for the equipment that belongs to the Milwaukee & Northern lines?

A. We have made an allowance for the equipment still in existence that once belonged to the Milwaukee & Northern Lines.

Q. Have you a statement here of that equipment?

A. There is remaining of the original Milwaukee & Northern equipment as of June 30, 1935, ten cabooses and thirteen passenger cars.

Q. What would be the approximate value of those ten cabooses and the passenger cars?

A. They are very old.

Q. Have you in your file a statement of the equipment that the Milwaukee & Northern Lines had at the time the lines were acquired and the mortgage assumed?

A. I have a record here taken from the stockholders report of the Chicago, Milwaukee & St. Paul Railway Company, issued on June 30, 1894.

Q. Is that already in the record?

A. No; I am not sure that is in the record. I am sure it is not. There is another exhibit, No. 117, in this proceeding, which gives a list of equipment.

2756 Q. That is the equipment as of that date?

A. Yes, sir.

Q. In preparing this Exhibit No. 156, did you take into account the covenants of the Milwaukee & Northern mortgages requiring the mortgagor to maintain the equipment?

A. No, sir; we did not allow for the equipment once owned, or make any allowance.

Q. There was the obligation of the mortgagor which was assumed by the St. Paul to maintain that equipment?

A. My understanding is there was no provision in the

mortgage that was mandatory for the replacement of that equipment.

Q. I have not a copy of the mortgage here, so I am unable to point to the provision. Now, have you any figures showing a division for other years than 1936 corresponding to your Exhibit No. 156?

A. No, sir.

Q. Are you preparing figures of that kind for 1937?

A. No, sir.

Q. Will you prepare such an exhibit?

A. It could be done. It will take some time.

Q. Will you please prepare one and make it available to us so that we may introduce it?

A. For what year?

Q. 1937.

2757 A. We have no final figures on 1937. It will take probably at least two months, I believe, before we get the actual figures for 1937.

Q. Petitions have been filed by the debtors and trustees from time to time requesting authority to pay interest on the Milwaukee & Northern issues?

A. Yes, sir.

Q. Those petitions have shown that there were ample earnings to cover that interest?

A. That is true.

Q. Those are before the Commission. I do not need to bring them out through this witness. Have you prepared any severance studies showing what the results of operation of the Milwaukee & Northern lines would have been if operated independently of the remainder of the St. Paul System?

A. No, sir. I take it by that you would mean considered as a foreign road?

Q. Considering it as a foreign road and with the allowance that would be made on interchange and charges for joint facility arrangements, etc.

A. We have in our set-up for the Milwaukee & Northern, in our division of freight revenues, a mileage prorate with a minimum of 25 per cent in separation of freight revenues between the System proper and the Milwaukee Northern. That is somewhat similar to the customary

2758 division given to a short line in that territory.

Q. Are those the divisions approximately in that territory?

A. It is very close to the divisions of the Green Bay & Western, about the same size road, running east and west in this territory.

Q. Have you undertaken to determine what the loss of revenue to the System would be if the Milwaukee & Northern were an independent, foreign line?

A. No, sir.

Q. This figure appearing on Exhibit 156 under the heading "Milwaukee System Earnings from Freight Traffic Interchanged With Milwaukee & Northern Lines", would not represent the loss to the System if the Milwaukee & Northern were excluded?

A. No, sir.

Q. It would be greater than that, would it not?

A. Well, it would not be any part of that—no part of that might be lost.

Q. It would depend on how the interchange was effected?

A. Yes, sir.

Q. On the division of those rates?

A. Offhand I know nothing that would disturb it.

Q. So that this $524,000 is approximately what the System would earn on traffic interchanged with the Milwaukee & Northern, assuming the Milwaukee & North-
2759 ern to be an independent line?

A. Yes, sir; that represents the System earnings on the business interchanged with the Milwaukee & Northern.

Q. Is there not part of that traffic which might properly be interchanged with other lines in that territory by the Milwaukee & Northern if operated on an independent basis?

A. I could not say.

Q. You have made no study of that kind?

A. No, sir.

Mr. Marsh: I think we are in need of that type of information before the position of the Milwaukee & Northern line or lines can properly be determined and before it can be properly determined what provision for the bonds of those two issues is fair and equitable. That type of study has been made in a number of the other cases that we are participating in, for instance, the Chicago & North Western case and the New Haven case, and I think quite a few others. I submit it would be appropriate to let the mortgage trustee of these issues investigate the subject with

representatives of the trustees to determine whether those figures are necessary. How long it would take to prepare them and what the cost would be could then be gone into. We are absolutely in the dark as we stand here today. It is quite obvious we cannot obtain any information of
2760 that kind from the witnesses if the studies have not been made.

Director Sweet: What efforts have you made up to this time to get that information?

Mr. Marsh: We were only served with this plan on the 10th or 11th of January, as I remember it. I wrote first to Mr. Burgess requesting what data he had and that it be made available. He told me at that time the data was being prepared by the Debtor's trustees, that he had nothing in the form of evidence or statements and would not have it until the hearings probably. I wrote to Mr. Dynes about the 20th, or somewhere in there. It was after I had written to Mr. Burgess. I received the same reply from Mr. Dynes—or I should say Mr. Dynes made no reply to my request as to the severance studies but I was informed that the segregation of earnings for 1936 was under way as between the north and south parts of the Milwaukee & Northern lines. It has been impossible for us to secure severance studies during the ten days after I received Mr. Dynes' reply. We may have to employ an expert—

Director Sweet: Is it your intention to endeavor to arrange with counsel for the submission of the necessary information?

Mr. Marsh: I should like to do so, but I have not been in contact with counsel until we met here today.

2761 Director Sweet: You are at liberty to negotiate with them. Let us know the result of your negotiations.

Mr. Marsh: Thank you. That is all.

Director Sweet: Are there any other questions?

Q. (By Mr. Ranteleoni.) Referring to Exhibit 158, I take it that is the only independent study that has been made of that portion of the revenues that are properly allocable to the general mortgage lines?

A. Of income?

Q. Of income.

A. Yes, sir.

Q. I also take it that this exhibit reflects the charges for equipment owned by the System?

A. In every case a rental has been charged against the mortgaged lines for the System equipment used and a proper credit given for the equipment that is considered to be under the lien of the mortgaged lines.

Q. I take it that charge is on the same basis of 5 per cent?

A. 5 per cent of the reproduction cost of the equipment, less depreciation.

Mr. Burgess: In order that there may be no misunderstanding, may I say this. You asked if that is the only independent study that has been made. There were
2762 several other exhibits introduced earlier in the hearing, which are referred to and which can properly be called independent studies of segregation of earnings.

Q. (By Mr. Panteleoni.) There is an independent segregation of earnings in Exhibit 145 which shows the earnings alleged to be allocable to the first and refunding bonds?

A. Yes, sir.

Q. There is another one for the Chicago, Milwaukee & Gary, another one for the Milwaukee & Northern, and another one for the Terre Haute?

A. That is true.

Q. There is no separate and independent survey of what is available under the general mortgage; that is assumed to be what is left?

A. That is true.

Q. I take it that the Milwaukee & Northern allocation as between the two first liens was made on an actual basis of the freight auditor's reports for an entire year, is that correct?

A. As between the two lines.

Q. The two lines.

A. Except as noted in the exhibit where the amounts are estimated.

2763 Q. On the other hand, I take it that in Exhibit No. 145—as a preliminary question, let me ask you, you are familiar with Exhibit No. 145?

A. Yes, sir.

Q. I take it that in Exhibit No. 145 the allocation which was made was based on a more or less spot check or selection of four months during the year?

A. The freight revenues were based upon an analysis of four months, January, April, July and October, I believe, and the relations obtained in those four months to

the State report figures. Those four months were used against the State report figures for the year to set up the freight revenue for the lines west.

Q. That is a different system than was used on the Milwaukee & Northern?

A. Yes, sir. The Milwaukee & Northern was actual for the entire year.

Q. I should like to ask quite a number of questions with regard to Exhibit No. 145, but I imagine it has been a while since you have seen Exhibit 145. We might postpone those questions in order to not interrupt the continuity here.

A. I am familiar with Exhibit 145.

Q. You will be available during this whole session?

A. I presume so.

2764 Mr. Panteleoni: May I have permission to recall the witness later for further cross-examination with regard to prior testimony?

Director Sweet: The witness may be recalled for further cross-examination.

Mr. Panteleoni: May I also state that so far as we are concerned, we are in somewhat the same position Mr. Marsh finds himself. There was a plan on file here which did not attempt to affect a single lien. Testimony was put in. The testimony was supposed to bear on the plan that was then filed.

Now, on January 10 an entirely new plan is filed, and we have to readjust our attitude and readjust our point of view. We have had no time within which to examine the exhibits. As a matter of fact, the exhibits filed this morning, understandably so, but nevertheless I am sure cannot be gone over because there are insufficient copies of all exhibits from 168 on and it is somewhat unconscionable to expect us to discuss a plan which has been filed only on January 10 and discuss evidence which has been given only this morning, even though I appreciate the desire of the Commission to close the hearing shortly. We respectfully request that we be given an opportunity to examine and study the exhibits.

2765 Director Sweet: Have you undertaken to secure from the trustees or the Debtor the information you think you need?

Mr. Panteleoni: Yes, but after I get that I want a period to study and the chance to further present testimony and a chance to continue further cross-examination.

Director Sweet: Any further questions of this witness?

Mr. Sykes: On behalf of the United States Trust Company, Trustee under the General Mortgage, we would like to have the same opportunity while this witness is here. We cannot intelligently frame any questions. I do not know as we will want to ask him any. I think it will all be brought out with reference to the relative earnings of the Milwaukee & Northern and the lines covered by the General Mortgage.

Director Sweet: The witness will remain here for further cross-examination.

(Witness temporarily excused.)

Mr. Burgess: I have here a copy of the Plan of Reorganization dated January 7, 1938, which was distributed to the parties and filed with the Commission on January 10, pursuant to its order. I ask that you have that marked Exhibit No. 174.

(The document referred to was marked "EX-
2766 HIBIT NO. 174, COUNSEL", and the same was received in evidence.)

Mr. Burgess: I have here a document entitled "Modified Plan of Reorganization, Amending the Plan Filed January 10, 1938", dated January 24, 1938, which was distributed to the various parties a week or thereabouts ago. I ask that that be marked Exhibit No. 175.

(The document referred to was marked "EXHIBIT NO. 175, COUNSEL", and was received in evidence.)

Mr. Burgess: The foreword in this document marked Exhibit No. 175 explains in general the changes that were made in the modified plan from that shown in Exhibit No. 174. At the time of filing this modified plan with the Commission we sent to the Commission five copies. If it is the desire to have additional copies, I have them here.

Director Sweet: We want thirty copies.

Mr. Burgess: We will present you with thirty copies.

FREDERICK W. WALKER was sworn and testified as follows:

Direct Examination.

Q. (By Mr. Burgess.) Mr. Walker, what is your name?
A. Frederick W. Walker, Milwaukee, Wisconsin.
Q. What is your occupation?

2767 A. Vice President in charge of bond investments, the Northwestern Mutual Life Insurance Company, Milwaukee, Wisconsin.

Q. What in general has been your experience?

A. I graduated from Stevens Institute of Technology, in Hoboken, N. J., in 1895, with the degree of Mechanical Engineer.

From September, 1895, to October, 1899, I was Assistant First Draftsman, then Assistant Steam Engineer, then Steam Engineer in charge of the Steam Department of all generating stations of the Edison Electric Illuminating Company, Brooklyn, N. Y.

From 1899 to 1903, I was Field Engineer for Westinghouse, Church Kerr & Company of New York, Engineer-Contractors, in charge of all construction in the Middle West, consisting principally of building and placing in operation high speed interurban electric railways, including road, power plants, substations, transmission lines, car-barns, and shops, assembly of equipment and placing railways in operation with a complete operating force.

From March, 1903, to July, 1922, Chief Engineer, Vice President and President, Comstock, Haigh, Walker Company of Detroit, Michigan, Engineers-Contractors, for financing, constructing and operating high speed in-
2768 terurban-electric railways for carriage of passengers, freight and express, and general engineering and construction projects.

From July, 1922, to March, 1926, Consulting Engineer, Chicago, Ill., serving banks, investment houses and estates.

From March, 1926, and thereafter to the present time, Vice President in Charge of Bond Investments, The Northwestern Mutual Life Insurance Company, Milwaukee, Wisconsin, which investments include Government bonds, Municipal bonds, Railroad bonds, Public Utility bonds, Industrial bonds, and Equipment Securities.

Q. You are the Chairman of a group of institutional investors which intervened in this proceeding and which has filed the Plan of Reorganization that has been identified as Exhibit No. 175, are you not?

A. I am.

Q. The organization of that group of institutional investors was preceded by the organization of a formal group, was it not?

A. It was.

Q. Please state what the facts are regarding the organ-

ization of both the informal group and later the formal group?

2769 A. The Debtor called a meeting of its principal creditors to be held in the Board Room of the New York Trust Company on May 23, 1935, to advise them that it was unable to meet its debts as they mature and that prior to July 1, 1935, it would file a petition in bankruptcy under Section 77 of the Bankruptcy Act as Amended. It was stated on behalf of the Debtor that it desired to obtain acceptance of a plan of reorganization by its principal bond holders prior to July 1st so that the plan could be filed with the Court and with the Interstate Commerce Commission promptly upon a petition being filed under Section 77 as Amended for the purpose of bringing about a prompt reorganization. A preliminary draft of a proposed plan of reorganization was distributed and explained by the Debtor, criticisms and suggested modifications were requested, and the meeting was adjourned to afford an opportunity to study the plan as proposed.

On June 4th, 1935, the creditors at a meeting held in the offices of the Mutual Life Insurance Company, New York City, requested Frederick W. Walker to act as Chairman of the Informal Group Representing Large Investors in the Debtor's Securities, and a Conference Committee, of not exceeding seven members, including the Chairman, was appointed to confer with representatives of the
2770 railroad company to work out modifications of the plan as then proposed to conform with views of the Group and to report back to the Group at the meeting to be held Wednesday, June 12, at 10:00 A. M. The Conference Committee met with representatives of the Debtor almost daily and reported back frequently to the Group until June 27th, 1935, when it authorized its Chairman to address the following letter to the Debtor:

2771 "Henry A. Scandrett, Esq., President, Chicago, Milwaukee, St. Paul and Pacific Railroad Company, Chicago, Illinois.

Dear Mr. Scandrett:

"At a meeting of representatives of more than twenty insurance companies, trust companies, and savings banks, owning substantial amounts of various issues of bonds of the Chicago, Milwaukee, St. Paul and Pacific Railroad Company, held June 26th, 1935, the following resolution was adopted by the majority vote of those present. No

votes were cast in the negative but several representatives did not vote either for or against the resolution.

'Resolved, that it is the sense of this conference of representatives of institutions holding securities of the Chicago, Milwaukee, St. Paul and Pacific Railroad Company that the plan submitted by the Company in draft form, dated June 24, 1935, would probably be acceptable to and would secure the support of the institutions which they represent.' "

Still reading from the letter:

"The subcommittee was authorized to review subsequent drafts prior to the filing of the plan, and if it finds no material changes to substitute the new draft for the draft
2772 dated June 24, 1935. Such changes as have been brought to the attention of the subcommittee at this time in final draft dated June 27, 1935, will not, in their opinion, materially change the plan submitted to the general committee and referred to above.

"The question of whether Trustees should be appointed or the property remain with the present management was also discussed at the meeting of representatives held June 26, 1935 and the following resolution was adopted:

" 'Resolved, that pending consideration of the reorganization plan, the additional expense of Trustees is unnecessary at least for the time being.' "

"Very truly yours,

"Frederick W. Walker,

"Chairman."

I might add, in connection with that, that the question was brought up at that time as to whether trustees should be appointed as the property was, by order of the court, at the filing of the petition left in the hands of the Debtor Corporation to be operated under the Orders of the Court.

The following acknowledgment and reply was received under date of June 28th, 1935:

2773 "Mr. F. W. Walker, Vice President,
Northwestern Mutual Life Insurance Company,
210 East Wisconsin Avenue,
Milwaukee, Wisconsin.

"Dear Mr. Walker:—

"I wish to advise you that the Board of Directors of this Company at a meeting held yesterday approved the plan of reorganization dated July 1, 1935, a copy of which is enclosed herewith, as a plan of reorganization to be

effected pursuant to the provisions of Section 77 of the Federal Bankruptcy Act.

"Prior to the adoption of the resolution approving the aforesaid plan your letter of June 27th was read to the meeting, having been received over the telephone.

Yours very truly,

R. J. Marony,

Vice President."

Now, that may seem to be rather an informal way of proceeding in connection with a matter of this kind, but it was felt by the institutional investors that it would be most advantageous to all interests, creditors and stockholders, if at the time, or about the time when the petition in bankruptcy was filed a plan of reorganization
2774 which appeared to have merit should also be filed so that in the operation of the property the Trustees in bankruptcy would feel that there were some obligations that they really should meet in connection with the operation of the property rather than that the property should merely be placed in bankruptcy in the hands of trustees without any plan of reorganization, in which event, there being no charges, or substantially no charges, or a very small amount of charges that had to be met, the money coming in from the operation of the property experience has shown is quite generally expended on the property.

The Debtor filed its petition for reorganization under Section 77 of the Bankruptcy Act as Amended on June 29th, 1935, and on the same day filed with the Court and the Interstate Commerce Commission the Plan of Reorganization dated as of July 1st, 1935, approved by its Board of Directors at a meeting held June 27th, 1935, and referred to in the letter of Frederick W. Walker, Chairman, to Henry A. Scandrett, Esq., President, dated June 27th, 1935, hereinbefore quoted in full.

I might add that there was no difference, except some slight modification of verbiage, between the plan filed and dated July 1, 1935 and the June 27th draft that was
2775 referred to in the letter of Frederick W. Walker to Henry A. Scandrett, President.

Now, following the filing of the plan of reorganization, a group of Institutional Investors, Holders of Chicago, Milwaukee, St. Paul and Pacific Railroad Company Securities (which for convenience is hereinafter called "the Committee"), the membership of which was limited to not more than twenty-five institutions, bonafide holders of

Chicago, Milwaukee, St. Paul and Pacific Railroad Company Securities, was organized from the membership of the Informal Group to act together for their own interests and not for others, through representatives or otherwise, pursuant to the provisions of Section 77 of the Bankruptcy Act, as Amended, under an agreement as of July 18, 1935, amended as of January 7, 1938, duly executed by each member company.

Frederick W. Walker was elected Chairman, Douglas Smith, Secretary and Kenneth F. Burgess was appointed Counsel for the Committee.

The par value of the securities of the several issues of the Chicago, Milwaukee, St. Paul and Pacific System including leased lines represented by the Committee as of July 18, 1935, was $69,035,600.

Subsequently additional institutional investors accepted membership in the Committee increasing the par
2776 value of the securities by the Committee to $81,731,200 and as of December 31, 1937 to $83,175,800.

The percentage so represented as of December 31, 1937, of the whole issue of those securities outstanding in each case, is shown in the statement marked Exhibit 176, which has been prepared, and which we would like to offer at this time.

Mr. Burgess: That statement just described by Mr. Walker will be marked as Exhibit No. 176. For the convenience of the parties we have distributed to them this morning nine exhibits, eight of which will be introduced in connection with the testimony of Mr. Walker, and the ninth in connection with the testimony of the next witness, and I think that at this time these several Exhibits should be marked so that they can be referred to hereafter by number.

The first Exhibit will be marked No. 176, which is entitled "Securities of Chicago, Milwaukee, St. Paul and Pacific R. R. Co., held by Life Insurance Company Group Committee as of December 31, 1937."

The next Exhibit, No. 177, entitled "Committee's forecast for the future average normal year."

The next one, Exhibit No. 178, entitled "Operating Revenues, 1921-1937."

Exhibit No. 179, entitled "Committee's forecast
2777 for future average normal year, Gross Revenues, Net Deductions, Income Available for interest."

The next one, marked Exhibit No. 180, entitled "Sum-

mary of allocation made by the Debtor of the Actual System Earnings for the year 1936, to mortgage districts, in designated exhibit, with various adjustments made by the Debtor separately shown, together with interest requirements."

Exhibit 181, entitled "Allocation made by the Debtor of the actual System Earnings for the year 1936, to mortgage districts, in designated exhibits, with various adjustments made by the Debtor separately shown, together with interest requirements."

Exhibit No. 182, entitled "Income Available for interest for 14 year period 1921-1934."

Exhibit No. 183, entitled "Income Available for interest for years 1921-1929, as modified."

Exhibit No. 184, entitled "Capitalization of Income Available for Interest Present Debt and Accrued, and unpaid interest July 1, 1938."

And Exhibit No. 185, which will be described in connection with the testimony of the next witness, entitled "Report of Examination made by representatives to members of Sub-Committees for the General Committee representing Institutional Investors."

2778 (The documents above referred to were marked for identification as "Exhibits Numbers 176 to 184, inclusive, Witness Walker, and also Exhibit No. 185 (Witness Scruggs)).

Mr. Burgess: Mr. Walker, proceed to describe the intervention by the Committee as so organized, in this proceeding.

The Witness: At the commencement of the first hearing before the Commission, (The Interstate Commerce Commission) on August 5, 1935, the Committee filed a petition of intervention (Transcript, page 7), and thereafter was duly permitted to intervene (Transcript Page 180).

Subsequently an order was entered in the court proceedings permitting the intervention of the Committee (January 21, 1936; Printed Record, page 819). The proceedings in the District Court and before the Interstate Commerce Commission have been followed throughout, several answers filed in the District Court, and numerous conferences have been held with representatives of the Debtor and others.

The Debtor's Plan was filed with the Debtor's petition in bankruptcy on June 29, 1935. The Interstate Commerce

Commission held several hearings on the Debtor's Plan on August 5, 6, and 7, 1935, June 16 and September 20, 2779 1937.

At the hearing before the Commission on August 7, 1935, counsel stated the position of the Committee in part as follows:

"In light of the actualities of the present situation, this Group (Committee) views the Plan (Debtor's) with favor, provided it can be adopted and accepted promptly so as to preserve its essential purposes, including the various protective provisions which have been incorporated in it."

On September 10, 1937, the Debtor filed with the Interstate Commerce Commission a petition setting forth changes which had occurred in conditions since the hearing on June 16, 1937 and the effect of those changes upon the operating expenses of the Debtor and upon the feasibility of the Debtor's Plan, and at the hearing on September 20, 1937, counsel for the Debtor stated that the Debtor's Plan required substantial amendments before it could be made practicable.

The Committee, after careful study of the Debtor's Plan, the testimony and exhibits offered by the Debtor in support thereof and after consideration of the entire matter, has concluded that it is not desirable to attempt to amend the Debtor's Plan of Reorganization and therefore pro- 2780 poses a new plan which in the opinion of the Committee will provide a sound capital structure, be compatible with the public interest, afford due recognition to the rights of each class of creditors and stockholders and have a likelihood of attracting a favorable vote of security holders entitled to vote thereon.

The Committee believes that in order that a plan of reorganization of the Debtor shall meet the requirements of sub-sections (b) and (e) of Section 77, provide a sound capital structure, be compatible with the public interest, afford due recognition to the rights of each class of creditors and stockholders, and have some likelihood of attracting a favorable vote of security holders, there should be incorporated within it the following principles:

(a) In order to provide a sound financial structure, restore the credit of the enterprise and permit necessary new financing, the capitalization should not exceed a conservative valuation of the assets to be taken over by the Reorganized Company and the proposed charges should be

within its probable earning power and afford a reasonable opportunity to function efficiently and continously as a going concern.

Mr. Abrams: May I at this time interpose an ob-
2781 jection? It appears that the witness is reading from a document filed as an Exhibit and there is no necessity of taking up the time of the Commission or of the lawyers here in re-reading it. If he has anything to add that is not in this Exhibit I think the witness should do it, but he should not be permitted to read this document.

Mr. Burgess: The Witness, Mr. Director, is about to read from pages 67 of Exhibit No. 176, the principles that have been incorporated in this plan (a) to (g) inclusive.

I have no desire to burden the record and if the Director desires in the interest of expediting the hearing we will pass over that.

Director Sweet: There will be no necessity of reading anything that is in the Exhibit.

Mr. Burgess: The matters are of vital importance, and the reason that Mr. Walker was about to read them was to call them to the attention of these gentlemen here, because they are fundamental in the structure of this Plan.

Director Sweet: You may direct attention to the page where they are of this Exhibit and pass on.

Mr. Burgess: All right.

The Witness: The principles which they cover in
2782 the reorganization plan of the Committee are shown on pages 6 and 7.

Mr. Burgess: Of Exhibit No. 175?

The Witness: Of Exhibit No. 175.

Examiner Jameson: Is this modified plan complete in itself so that no reference need be made to the first one?

Mr. Burgess: You are quite correct, Mr. Examiner, no reference need be made to the first one. We introduced the first one here as a matter of record, to have it filed on the tenth of January, and this is merely setting forth these fundamental principles, which appear on pages 6 and 7 of Exhibit No. 175.

The Witness: That is correct.

Mr. Burgess: Now, will you please state the manner in which the Committee proceeded, that is, dealing first with the matter of Experts and reasons for their non-employment?

The Witness: The Debtor's Plan of Reorganization dated

as of July 1st, 1935, was, on its face, a "standby Plan" designed to preserve existing priorities and rights of various classes of securities affected and to open up or disturb existing mortgages only in so far as necessary to produce a sound capital structure in the event the earning ca-
2783 pacity of the road was restored within the "Standby Period" of five to ten years to the extent which at the time the "Standby Plan" was promulgated appeared to have a reasonable prospect of being realized.

In view of the nature of the Debtor's Plan and of the means available within the organizations of the members of the Committee to analyze the testimony and Exhibits to be introduced by the Debtor in support of its "Standby Plan," the Committee felt that the expense of employing independent experts in this instance was not justified.

Based upon the record, studies available to the Committee, information obtained in conferences with the Debtor and upon knowledge of the territory served, the Committee concluded that:

The failure of the Debtor to meet its obligations in 1935 was due to a number of causes, among which were:

(a) The general effects of the depression, adverse crop conditions and the increased competition from motor vehicles, inland waterways, coastwise shipping via the Panama Canal, pipe lines and air transport.

(b) Debt bearing fixed or contingent interest, which was excessive under the conditions next above recited.

2784 (c) Inability to reduce expenses sufficiently to absorb the decrease in revenues.

The Committee, after careful study of the Debtor's Plan, the testimony and exhibits offered by the Debtor in support thereof and after consideration of the entire matter, has concluded as previously stated, that it is not desirable to attempt to amend the Debtor's Plan of Reorganization and therefore proposes a new plan which in the opinion of the Committee will provide a sound capital structure, be compatible with the public interest, afford due recognition of the rights of each class of creditors and stockholders and have a likelihood of attracting a favorable vote of security holders entitled to vote thereon.

The Committee believes that the present operating management of the Debtor has been efficient, that the properties are in good condition, have little deferred maintenance and will require only normal expenditures for capital account,

and that needs for additional equipment can be financed from equipment depreciation funds and equipment trusts. It is also believed that the cash position will be such that the reorganized company will have adequate working capital after absorbing the expenses of reorganization.

2785 Therefore, it is concluded that no new money will be needed in the reorganization.

The Committee has arrived at the conclusion that the equities of the Preferred and Common stockholders of the Debtor, respectively, have no value.

The Committee has arrived at the conclusion that the public interest will best be served and the soundest basis for the reorganization of the Debtor established—

Mr. Abrams: May I at this time object to any conclusions given by the Committee or the witness. The Witness has the right to testify and bring out the facts. Conclusions are for this Commission and I would therefore ask that every statement of belief or conclusion not predicated upon evidence be stricken from the record.

Director Sweet: The objection will be noted and overruled for the purposes of the hearing.

The Witness: The Committee has arrived at the conclusion that the public interest will best be served and the soundest basis for the reorganization of the Debtor established if the properties of the Chicago, Terre Haute and Southeastern Railway Company are consolidated with those of the Debtor and the mortgages of the reorganized

2786 company are extended to the Terre Haute properties.

The Plan of Reorganization dated January 7, 1938, presented by the Committee and filed with the Interstate Commerce Commission January 10, 1938, as amended by the Modified Plan of Reorganization dated January 24, 1938, contemplates that appropriate proceedings will be taken to effect this result.

In the event that the Commission and the Court shall not support such consolidation of properties of the two companies as the basis of the Plan of Reorganization, an alternative treatment under the Plan, of the bonds of the leased Terre Haute lines is provided, involving the continuation of the Terre Haute lease with certain reasonable limitations of existing burdens thereunder.

This alternative is regarded by the Committee with distinctly less favor. The text of the Plan is drawn on the assumption that the consolidation basis of reorganization will prevail.

Modification of statements in the text relative to capitalization, earnings, et cetera, necessary to align the Plan on the alternative basis of continuing the Terre Haute lease may be made by reference to "Alternative Exhibits" "A", "B" and "C" of the Plan.

Q. (By Mr. Burgess.) Now, Mr. Walker, what
2787 were the problems that were based by your committee evolving this plan of organization that has been presented as Exhibit No. 175?

A. It was recognized that the problems involved in formulating a Plan of Reorganization which would conform to the provisions of Section 77, while not as complex as in some other railroad bankruptcies in which many of the Committee members were endeavoring as creditors to work out plans of reorganization, were, however, numerous among which were:

(1) Determination of fixed charges which the Reorganized Company could safely carry. (These are shown at Pages 11-12 Plan—Exhibit D, Page 57, Plan.)

(2) Determination of the various classes of new securities, their characteristics and amounts which would create a sound capital structure.

(3) Provision for Improvements and Betterments, including Motive Power and Equipment required to render safe and adequate service to the public.

(4) Disposition of the Debtor's subsidiary, The Chicago, Terre Haute and Southeastern Railway Company, now being operated under a 999 year lease expiring July 1, 2929; The Debtor now being in default as to certain requirements thereunder. (Debtor's Exhibit No. 63 Lease,)

(Equipment deficiency $7,106,149 D-1 December 31,
2788 1937).

(5) Providing fair and equitable treatment for (a) Equipment Trusts (b) Loans Secured by Collateral (c) Bonds outstanding under four (4) Leased Company Mortgages (d) Bonds outstanding under six (6) Mortgages of the Debtor (either direct or mortgages assumed by the Debtor.)

Q. Now, the Exhibit No. 175, containing the Modified Plan of Reorganization is the Plan which was prepared and approved by the Committee to conform to these principles previously stated and to deal with these several problems that you have just described, was it, Mr. Walker?

A. The Modified Plan of Reorganization for Chicago,

Milwaukee, St. Paul and Pacific Railroad Company, dated January 24, 1930, hereinafter called the "Plan", amending the plan filed with the Commission January 10, 1938, is presented by Group of Institutional Investors, Holders of Chicago, Milwaukee, St. Paul and Pacific Railroad Company Securities, for consideration and approval by the Interstate Commerce Commission.

In reaching a conclusion on the amount of fixed interest bearing debt, and the rate of interest thereon which would result in fixed charges in such an amount that there shall be adequate coverage by the probable earnings avail-
2789 able for the payment thereof in future periods of depressed business, the actual earnings available for the calendar years 1930-1936 were determined in the following manner. Representatives of Institutions, Members of the Committee, examined the Income Accounts and Profit and Loss Accounts of the Debtor and conferred with its officers to determine what, if any, modifications should be made to the reported earnings available for fixed charges for the years 1930-1936.

Mr. Burgess: I think we have described that sufficiently, and I was about to ask you to discuss the first of these Exhibits, that is the matter of the determination of fixed charges, which the reorganized company could safely carry.

Director Sweet: Mr. Walker, did you also do all these things yourself?

The Witness: In connection with these conferences, I did attend some of the conferences, but the result of these conferences, and this adjustment of income is included in Exhibit No. 185, the report, and will be testified to by the representative responsible for the report and I am merely here outlining what was done in determining these charges and getting the information necessary upon which to
2790 reach a conclusion.

Director Sweet: Are you personally satisfied with the information that you got and with the conclusions that are represented here in this plan?

The Witness: I am.

Director Sweet: You could state that this plan represents your views, your findings of fact as you discovered them, and things of that sort?

The Witness: The plan represents my views and my conclusions from the information which has been made available to me and which I have studied, and in my opinion also

represent the views of the Committee, of which I am Chairman.

Director Sweet: I was asking, because it might be easier for counsel to cross-examine you than to cross-examine the several members of the committee.

The Witness: Yes, sir, and I am ready to be cross-examined on the views which are here submitted as the views of the Committee as they are my own views.

From these conferences it was concluded that the items, and I might add here, in connection with these items that I participated in the conferences at which the decision was made as to the necessity for undertaking the investi-
3791 gation of the various items that appear in the report, Exhibit No. 185, that will be testified to.

From these conferences it was concluded that the items that should be examined in detail were:

1. Equipment Depreciation and Retirement Charges.
2. Amortization of Debt Discount.
3. Tax Adjustment with the State of Washington.
4. Rate Divisions between Western and Eastern Carriers.
5. Railroad Retirement Taxes not Actually Incurred.
6. Abandonments and Retirement of Road Property.
7. Coordination of Ore Traffic with Chicago and North Western.
8. Extraordinary Rehabilitation, and;
9. Electric Power Purchased.

The income available for interest and for net rental under the Terre Haute Lease for the years 1930-1936 as reported by the Debtor to the Interstate Commerce Commission has been modified as a result of this examination as shown on Page 10, Plan, and Exhibit D, Page 57 of the Plan.

Page 10 of the Plan merely shows the summary. Exhibit "D", page 57 of the Plan is a statement showing the various income accounts, income account items which
2792 entered into the adjustments, and from which the final results as adopted by the Committee were obtained, and the modifications following the conclusions reached were set forth in Exhibit No. 184, which will be testified to later.

Now, these changes consisted of adding back net rental under the Chicago, Terre Haute and Southeastern Railway Company Lease, and adding back Equipment Retirement

charges which are chargeable to depreciation reserve under the Commission's order with respect to accounting for equipment depreciation, effective January 1, 1935; adjustment of depreciation accruals as made by the Interstate Commerce Commission Bureau of Accounts (Use of Depreciation Rates in Effect January 1, 1935, and after giving effect to writ-down of $31,718,445 in book value of equipment in 1934), adding back the amount of amortization of debt discount; charges under railroad retirement act, not actually incurred; and by deducting tax adjustment with State of Washington charged to profit and loss in 1934, but includable in 1928-1934 income account.

For the reasons stated in the report, no adjustments were made for the following items:

Rate Divisions between Western and Eastern Carriers.

2793 Railroad Retirement Taxes not actually incurred.

Abandonments and Retirements of Road Property.

Coordination of Ore Traffic with Chicago and North Western Electric Power Purchased.

The five and six year averages of income available for interest and for net rental on the Terre Haute Lease as so modified are shown on Pages 11 of the Plan, and Exhibit D, Page 57 of the Plan and are particularly called to the attention of the Commission at this time, as follows:

The five years average for the years 1930-1934, was $10,876,020.

The five year overage for the years 1931-1935, was $7,859,106.

The five year average for the years 1932-1936, was $8,042,941.

The six year average for the years 1931-1936, was $8,599,072.

It will be observed that the most critical period was 1931-1935 and as the periods 1932-1936 and 1931-1936 showed somewhat greater average annual income available for interest and for net rental under the Terre Haute Lease, $7,859,106, the average annual income available for interest and for net rental under the Terre Haute

2794 Lease, for the period 1931-1935, was taken as the safe minimum to be reasonably expected in the future in view of the fact that this period includes the years of maximum business depression, includes years of exceptional drought and reflects intensified competition from other forms of transportation.

The limit for fixed charges at reorganization was, therefore, fixed at not to exceed $6,750,000 in order to insure ample coverage during periods of minimum earnings reasonably to be expected.

In this particular territory in which this road operates, the five-year average 1931-1935 appears to have been the period of minimum earnings quite generally, minimum average earnings. And that has been adopted, and I believe that it is the sound and conservative thing to do to adopt that period as the period of probable minimum future earnings.

The soundness of the capital structure of the reorganized company will necessarily be dependent upon its earnings capacity in the future.

The record shows, pages 186 to 190, that a careful study of the revenues of the Debtor and the conditions affecting the same was made by and under the direction of its Officer in Charge of Finance, Accounting and Real Estate, and that as a result an estimate of the future earnings
2795 of the Debtor was made which, because of the many unknown quantities to be considered, was based upon the following broad assumptions which to it appeared reasonable.

Mr. Burgess: Now, those assumptions are stated, Mr. Walker, are they not, on pages 11 and 12 of Exhibit No. 175?

The Witness: Yes, they are.

Q. (By Mr. Burgess.) And those are the assumptions to which you desire to direct attention at this time?

A. As the Debtor's assumptions?

Q. Yes.

A. Yes.

Q. And they are the assumptions that are stated in our plan and have been testified to by the Debtor as the assumptions on which their estimate was based, as I understand it?

A. That is correct.

Director Sweet: Is it necessary for you to adopt or discuss those assumptions, in supporting your Plan?

The Witness: Yes, sir.

Director Sweet: Proceed.

Mr. Burgess: We are not going to read them, your Honor, I directed attention to the fact that they are
2796 in the record and Mr. Walker is making use of them as he will explain.

Mr. Swaine: When you said they were the Debtor's assumptions, you meant they were the assumptions stated on a hypothetical earnings study made in 1935?

The Witness: They were the Debtor's assumptions as shown in the record.

Mr. Swaine: In 1935?

The Witness: In 1935, which the record shows, and which to the Debtor appeared to be reasonable, and in the examination of the Debtor's witness it was stated that while he did not signify, or the record shows that while this was not signified as a forecast but as an estimate, yet it was believed by the witness for the Debtor that this was the reasonable amount, viewing the situation conservatively, which could be looked forward to in the future as the average earnings in the normal year. The record there will speak for itself.

Conferences on this subject with the Debtor—and I might say that I personally had a number of conferences on this subject—disclosed the large amount of time and thought that had been devoted to the preparation of this estimate by officers and other members of the Debtor's organization and the conclusion was reached—

2797 Director Sweet: By whom?

The Witness: By me and by others with whom I naturally discussed the matter, but primarily by myself.

—that because of their familiarity with the property and with the territory in which it operates and because of their knowledge of the possibilities and conditions of the property, a forecast based on the estimate would prove to be sound.

Now, these three assumptions that were made by the Debtor in the record covered freight revenue and covered passenger revenue; that is, freight operating revenues and passenger operating revenues.

Director Sweet: Are you accepting those forecasts?

The Witness: Those forecasts are accepted for those freight revenues and passenger revenues as being the amount that can reasonably be expected in the average normal year to be earned by this property.

Director Sweet: And your plan is based on your belief that those are reasonable forecasts as to freight and passenger earnings for the future?

The Witness: Yes, sir.

Director Sweet: All right.

2798 The Witness: All other operating revenues were consolidated into one item and examined, and they were also examined independently as to independent items, and during the fourteen year period upon which this forecast or estimate of the Debtor was based for passenger and freight revenues, namely 1921 to 1934, both inclusive, it was found that all other operating revenues during this fourteen year period bear a comparatively uniform relation to freight revenues and the assumption was therefore made—

Director Sweet: By whom?

The Witness: And it was made by me in conference with those who had compiled the information which I directed them to compile, and by me was transmitted to the Committee in the meetings which we held on this subject.

The assumption was therefore made that all other operating revenues as in the case of freight revenues, will not fall below the average for the fourteen year period, 1921 to 1934, by more than 10 per cent.

Now, in support of that conclusion I have caused to be prepared an Exhibit, No. 178, which shows, in the first column, operating revenues; in the second column—the first column freight revenue, the second column passenger revenues, in the third column all other revenue, in the
2799 fourth column all other revenue in per cent of freight revenue, in the final column total revenues.

Now, it will be noted that the Chicago, Milwaukee and Gary earnings for the period January 1, 1921 to April 1, 1930, which were not included in the earnings as reported by the Debtor Corporation, were put back into the earnings, so that the earnings in each of these years would be properly comparable.

And during this period 1921 to 1937 all other revenues in comparison to freight average 12.7 per cent.

Now, examination will show that 12.7 per cent of freight revenues, an examination will show, it seems to me that that showing was sufficient to justify the conclusion that all other revenues varied on this property fairly uniformly with freight revenues, and if that was the case, and under the assumption made by the Debtor that owing to competing forms of transportation the future average railroad freight earnings exclusive of increase in population, will be less than it was in the fourteen year period 1921 to 1934, and that with the regulation of all forms of trans-

portation, some measure of Fourth Section relief, and
2800 the efforts the railroads are making to recapture business, it would not seem unreasonable to conclude that the future average of railroad freight earnings when we emerge from the depression will not fall below the average of the fourteen year period, 1921 to 1934 by more than 10 per cent, that being the assumption of the Debtor after a study of the situation, that being my conclusion after examining the record, and discussing the matter with the Debtor, I came to the conclusion that it was proper and reasonably sound to assume that all other operating revenues would not fall below the average for the fourteen year period 1921 to 1934 by more than 10 per cent.

Director Sweet: You are talking about expenses now?

The Witness: Revenues.

Did I say expenses?

Mr. Burgess: Just one place.

The Witness: The average gross revenues arrived at under these assumptions amount to $120,319,000 (shown on page 12 of the Plan) compared to $121,000,000 in round figures in the Debtor's testimony on the estimate (Pages 190-191 of the record).

The Debtor's assumptions specifically exclude from its estimate any increase in volume of traffic from growth of the country. There is no question but that this nation
2801 will continue its growth, and it seems reasonable to conclude that the Debtor will enjoy some increase in its revenues as a result of such growth.

In the reasonably near future an increase of from 5 to 6 per cent in revenues from growth is believed to be sufficiently conservative to insure realization and therefore 5½ per cent of $120,300,000, the estimated average gross revenues, or $6,600,000 arrived at as outlined above, was taken as the amount to be added to the gross revenues for growth, making the average gross revenues for the normal year $126,900,000.

This is shown on Exhibit Number 177 entitled "Committee's Forecast for the Future Average Normal Year, Gross Revenues." The freight revenues, less 10 per cent, average for the fourteen years, 1921 to 1934 are shown as $99,117,000; passenger revenues, average during the same period, less 50 per cent, $8,202,000; balance, which means all other revenues, $13,000,000; and increase from growth $6,581,000, or a total forecast of gross revenues for the future average normal year of $126,900,000.

In examining the record it was found that Debtor's
2802 Exhibits 121 and 133 contained an estimated Income Account for the year 1939 in which the total railway operating revenues are $126,900,000, although the distribution of these revenues between freight, passenger, and all other revenues is somewhat different from the distribution in the total of $126,900,000 arrived at as shown in the Exhibit introduced by the Committee at this hearing, Number 177.

The railway operating expenses and other income items in Exhibit No. 121 are estimated on the same level of freight and passenger rates, the cost of materials and supplies, scales of wages and pension and unemployment taxes as have been used as a basis of the plan, namely those that were in effect June, 1937, (Exhibit No. 121 and Record Pages 544-548-549) as the level upon which the plan is based.

The Committee has therefore adopted as its forecast of eventual earnings for the future average normal year before Federal Income Tax and Surtax on Undistributed Profits, Gross Revenues of $126,900,000, less Net Deductions arrived at by appropriately adjusting the Income Statement assumed by the Debtor for the year 1939 (namely Debtor's Exhibits 121 and 133), resulting in the following forecast:

Gross Revenue for the average normal year $126,900,-
000.

2803 Net Deductions $111,006,000.

Net Income available for interest average normal year before Federal Taxes $15,894,000.

The detail of this income account is shown on Exhibit No. 179, introduced by the Committee into the record this morning.

And at this point I would like to call to the attention of the Commission the fact that there is included in Operating Expenses in the average normal year, as shown on this sheet, depreciation of equipment in the amount of $6,014,000.

Director Sweet: Well, is that expression "Average normal year" one that you have originated, or did the Debtor originate that expression?

The Witness: That is the Committee's expression and it is the manner in which the Committee designates its forecast and the forecast for the future average normal year.

Director Sweet: Well, what did you do, take a bunch of normal years and make an average of them, or how did you get at that?

The Witness: No, you do not, you can't do that.

Director Sweet: What is the basis for that average normal year, what you may expect over a period of years in the future?

2804 The Witness: On the average, that is an average.

Director Sweet: Good years and bad?

The Witness: Good years and bad.

Director Sweet: All right.

The Witness: Yes, sir.

I think that Exhibit No. 179 just referred to explains itself. The modification that was made was that there was excluded from the Income Accounts, as shown on Debtor's Exhibit No. 121, accruals for Federal Income and Undistributed Profits Taxes which had been estimated under the Income Account set up that had been made by the Debtor.

Director Sweet: We will take a recess now until two o'clock.

(Whereupon, at 12:30 o'clock p. m. an adjournment was taken until 2:00 o'clock p. m. of the same day.)

2805 Afternoon Session.

2:00 o'clock p. m.

Mr. Burgess: Shall we resume, Mr. Director?

Director Sweet: You may proceed, Mr. Burgess.

FREDERICK W. WALKER, testified further as follows:

Direct Examination (Continued).

Q. (By Mr. Burgess.) Mr. Walker, you were about to discuss the provision for restoring deferred maintenance, the consideration that you had given to that subject.

A. The record discloses that in the opinion of the officers of the railroad thoroughly familiar with the condition of the property there was little, if any, deferred maintenance, in fact that the condition of the physical property

was if anything improved compared to its condition in the prior depression period. (Starting at Page 564 of the record.)

The record also discloses (Pages 647-648) that a witness for the Debtor, from the restricted viewpoint of not having made a personal inspection of the property in recent years and appreciating the fact that for a given volume of traffic, maintenance man-hours have been permanently reduced and that therefore an examination of maintenance expenditures alone will not disclose the facts with respect to the true condition of the property—

2806 Director Sweet: Now, we are interested, of course, in knowing what is in the record.

The Witness: Yes, sir.

Director Sweet: But we are presumed to know about those things. Couldn't you tell us what you think about the proposition without giving us so much about the matter already in the record?

The Witness: Certainly, sir.

Personally and as Chairman of the Committee I have been over the main line from Chicago to Seattle, I am familiar with a considerable portion of the territory served, I have gone through the Milwaukee Shops on several occasions, and from other information available I am of the opinion that the track and structures have been well, and economically maintained, that advantage has been taken of mechanical aids in reducing maintenance costs, that the equipment condition, both locomotive and car, is good and that facilities for its maintenance are adequate and repair costs economical.

I have, therefore, concluded that there is no deferred maintenance of road structures or equipment requiring special provisions in the Plan for its restoration and that the charges of $19,000,000 for Maintenance of Way

2807 and Structures and $18,800,000 for Maintenance of Equipment in the Committee's forecast for the average normal year are adequate to maintain the property in a high state of efficiency and that the charge for Depreciation on Equipment of $6,014,000 in the forecast will provide for replacement of the equipment at the expiration of its useful life if the funds are segregated and devoted to the purposes provided under the Reserve and Retirement Fund incorporated in the Plan (Page 23).

Q. (By Mr. Burgess.) Now, what consideration did

you give in determining the capital structure that is proposed in our plan of reorganization for the new company.

A. Consideration was given to the following requirements:

(a) Funded Debt should not constitute an excessively large percentage of the capitalization after reorganization; that

(b) The annual charges on the fixed interest debt must be covered during periods of minimum earnings reasonably to be expected; that

(c) The annual charges on the contingent interest debt should be covered by the probable normal future earnings, after provision is made for a limited improve-
2808 ment and betterment fund.

(d) Dividends on preferred stock should be assured with a moderate increase over the probable normal future earnings;

(e) A return on the common stock should be possible as the bonded debt is reduced through the operation of sinking funds, or through conversion privileges, or through additions to property from earnings not capitalized, or from more efficient operation and as an improvement in general economic conditions occurs.

The amount of new securities to be issued was, therefore, based upon, and their quality graded according to application of these principles to minimum earnings reasonably to be expected to $7,859,000 (Page 11 and Exhibit C, Page 55 of the Plan) and the probable income for the future average normal year before Federal Income Tax and Surtax on Undistributed Profits of $15,894,000 with the following results:

On page 17 of the Plan, the table at the top of the page shows the comparison between the present fixed debt, contingent interest debt, preferred stock and common stock constituting the total capitalization, and the capitalization proposed under the Plan.

In regard to the fixed interest debt, the fixed inter-
2809 est debt proposed under the Plan constitutes 49.3 per cent of the present fixed interest debt.

Q. Isn't that,—it is a decrease, Mr. Walker, is it not?

A. That is correct: the present fixed interest debt is decreased 49.3 per cent. Adding to the present interest debt, the accrued and unpaid interest on July 1, or June 30th, 1938, we would have a present fixed interest obligation of $354,866,000, which is a decrease between the

present total fixed interest debt as shown, roughly, and the fixed interest debt provided for in the Plan is 54.1 per cent decrease.

The total contingent debt is decreased 56.1 per cent and the total debt which included accrued interest on present obligations, is decreased 55 per cent; namely from $613,163,000 to $276,198,000.

Director Sweet: That includes all the accrued interest on the adjustment bonds.

The Witness: The interest accrued and unpaid on the adjustment bonds prior to the bankruptcy is included, together with the interest which is accrued and unpaid since the bankruptcy and calculated to June 30th, 1938, that being the obligation of the corporation to the adjustment bondholders which is prior as to its status to the rights of the stockholders either preferred or common of the
2810 corporation.

Director Sweet: That accumulation would figure about $74,978,000?

The Witness: Yes, sir.

Director Sweet: And that is accumulated because the contingent interest in that case is cumulative?

The Witness: Yes, sir, the contingent interest was fully cumulative after a period of either three or five years, I do not remember exactly, but there was full accumulation after a limited period.

Mr. Swaine: January 1, 1930.

The Witness: Thank you.

The total capitalization, based on including in the present capitalization accrued and unpaid interest, both on the fixed interest debt and the contingent interest debt, to July 1, or rather to June 30th, 1938 is $849,876,000, and as provided in the Plan $640,687,000 or a reduction of 24.6 per cent.

Director Sweet: Now, are you satisfied, Mr. Walker, from any inquiry which you have made, that capitalization, that it is not excessive or otherwise improper with relation to any appraisal that may have been made that you might have in mind, of the capitalizable assets?

The Witness: I have given consideration to that
2811 and the basis for the value of the assets, as to that phase, that particular phase, being the value of the physical property, is shown in the report of Division 4, the Bureau of Valuation, which is filed in this proceeding, on the elements of value of the Debtor's Railway Property

as a whole and separately, by mortgage divisions, as of December 31, 1935.

The elements of value included in that report are original cost, except land, for the Chicago, Milwaukee, St. Paul and Pacific Railway; the cost of reproduction new; cost of reproduction, less depreciation; the value of lands and rights and working capital to which should be included, under the provisions of the Plan, which are based upon the Terre Haute Lines being consolidated with the Debtor's Lines.

We also have, with respect to the Terre Haute Railway, in the report of the Bureau of Valuation, the original cost, except lands, the cost of reproduction new, the cost of reproduction less depreciation, and the value of lands and rights.

In this connection, it should be noted that the claims of the Debtor's creditors outstanding as of June 30th, 1938 will be $613,162,979 and therefore the effect to be given to
2812 these elements of value, in the light of the earning power of the property and all other relevant facts, supports, in my opinion, the conclusion that the stock of the Debtor is without value.

Q. (By Mr. Burgess.) Now, that report of the Bureau of Valuation I understand is a part of this record?

Director Sweet: It was filed in this record by direction of an Order of Division 4. Under the Statute the Commission may direct its employees to prepare reports and make them part of the record, where they are supposed to be prima facie evidence, and this report was submitted under an order drawn pursuant to that provision.

Q. (By Mr. Burgess.) Mr. Walker, in determining both the total capitalization under this Plan and in arriving at the conclusion that the stock was without value, you gave consideration, among other things to those elements of value set forth in that report, did you not?

A. I did.

Director Sweet: You also gave consideration, you considered the earning power of the carrier?

The Witness: Yes, sir.

Director Sweet: On the basis of the reports as to its earning power, in the first place, and with consideration to some forecast you have considered also?

2813 The Witness: Yes, sir, and I gave consideration to past, present, and prospective earnings. The past earnings—

Director Sweet: Well, proceed.

Mr. Burgess: We are going to cover that in some little detail a bit later, although if you would prefer we will do it now.

Director Sweet: Well, I just wanted to ask this one question:

What bases of earnings have you capitalized or would you capitalize in order to produce the total capitalization of $640,000,000 for the carrier?

The Witness: I might answer that first, if I may; that capitalization of $640,000,000 is made up of securities having a par value, total par value of $352,000,000. And the balance, of $286,258,000, consists of common stock 2,862,080 shares, which for purposes of the statement as to capitalization and comparison with the present capitalization, and for illustration is assumed to have a value of $100 per share.

Now, the reason why it was essential, as I saw it, to have no par common stock, is that the future average annual income available for interest is a matter of
2814 estimate and forecast, and therefore if the entire capitalization of the company, of the reorganized company, consisted of securities all of fixed par value, no provision would have been made in that capital structure for the possible fluctuations, up or down, in the average annual earnings over the future that would actually be enjoyed, and therefore the capital structure consists of securities having a definite and fixed par value down through the preferred stock and then no par common stock.

In the capitalization of earnings, the earnings have been capitalized, as will be shown later in more detail, on the basis of 5 per cent, and also on the basis of 4.7 per cent, which is the average rate of interest that the present outstanding debt is drawing. Both of those bases have been used for capitalization.

I believe that a 5 per cent basis of capitalization of earnings is a reasonable basis. However, the proper percentage to apply for capitalization depends upon, to very considerable extent, the risk in the business, namely, the risk in the investment.

Mr. Burgess: We are going to give some figures, a little later, Mr. Director.

Director Sweet: All right.

Mr. Burgess: A statement of capitalization of earnings.

2815 Q. (By Mr. Burgess.) Now, Mr. Walker, what coverage does your plan provide for the fixed charges, in your opinion?

A. As disclosed in Exhibit B, page 53 of the Plan, the fixed charges will amount to $6,556,000, which is 83 per cent of the $7,859,000, the minimum income available, (Exhibit C, pages 55 of the Plan), and gives a coverage of 1.20 times fixed charges.

I might direct attention here to the fact that there is not included in the fixed interest debt of July 1, 1938, $10,000,000 of first mortgage bonds which are to be issued and held in the treasury as reserve for emergencies.

The fixed charges of $8,556,000 are followed in the order named in the prospective normal year by an Addition and Betterment Fund payment of $2,538,000; by Contingent Interest on General Mortgage bonds Series A of $2,855,000; by Contingent Interest on General Mortgage Bonds Series B of $2,491,000; by Sinking Funds on General Mortgage Bonds issued of $566,000, aggregating $15,006,000 compared to the probable income available for interest for the future average normal year of $15,894,000 leaving a balance of $888,000 for dividends and other corporate purposes, but before Federal Income Taxes and Surtaxes
2816 on Undistributed Profits.

The soundness of the capital structure proposed in the Plan, resulting from the application of these principles is in my opinion, evidenced by the following:

(a) The capitalization is made up of 43.1 per cent debt, consisting of 25.4 per cent fixed interest bearing and 17.7 per cent contingent interest bearing debt and the balance 56.9 per cent stock. (This is shown Exhibit B, Page 53 Plan.)

(b) Fixed interest will be covered 1.20 times by the average minimum annual earnings and 2.42 times by the earnings in the average normal year.

(c) After payment to the Additions and Betterment Fund of $2,538,000 Contingent interest on General Mortgage Series A Bonds will be covered 2.38 times in the normal year.

(d) After payment of interest on the General Mortgage Series A Bonds Contingent interest on the General Mortgage Series B bonds will be covered 1.58 times.

(e) And after payments into the sinking funds for General Mortgage Bonds Series A and Series B of $566,000, there will remain for dividends and other corporate
2817 purposes before provision for Federal Income Taxes and Surtaxes on Undistributed Profits a balance of $888,000.

In other words in an average normal year the following obligatory amounts would and discretionary amounts could go back into the property under the Plan:

Obligatory payments to Additions and Betterment Fund	$2,538,000
Obligatory Sinking Funds	566,000
Total Obligatory Payments	$3,104,000
Balance available for discretionary payments to A & B. Fund	888,000
Total Obligatory & Discretionary amounts	$3,992,000

Now, one of the provisions in this Plan which I believe is essential to the preserving of sound capital structure is that after the payment of fixed interest there should be an obligatory additions and betterments fund payment. This should be obligatory if earned, and any unused balance should, as will be later explained, go over into the reserve and retirement fund.

I further believe that there should be an obligatory sinking fund and that the sinking fund should follow the
2818 contingent interest so that the capital structure is maintained through these various means to some extent at least, by these means, and then by others, other provisions incorporated in the Plan, within reasonable limits of the structure that is set up at reorganization with respect to the relative proportion of debt to stocks and the relative proportion of debt to property.

The interest coverages and payments given above are based upon the level of freight and passenger rates, and the cost of materials and supplies, scales of wages, and pension and unemployment taxes in effect June, 1937.

Subsequent increases in wage scales and the cost of materials have not been provided for, it being assumed by the Committee that they will be compensated and offset by rate adjustments or otherwise.

Q. (By Mr. Burgess.) Now, what have you to say about some of the other features of the plan, Mr. Walker, the disposition of the debtor's leased line, the Chicago, Terre Haute and Southeastern Railway Company?

A. The Chicago, Milwaukee, St. Paul and Pacific Railway Company, predecessor of the Debtor, leased the prop-
erty of the Chicago, Terre Haute and Southeastern
2819 Railway Company, under a lease agreement dated July, 1921 for a period of 999 years, terminating July 1, 2920. This lease was assumed by the Debtor.

The lease rental consists primarily of interest on funded and unfunded debt, taxes and corporate expenses of the Terre Haute not exceeding $12,000 per annum.

The Terre Haute lease obligates the Milwaukee to fulfill the covenants of the leased Company mortgages. (Exhibit 63, Art. 3, Section 3, P. 11.) The mortgages themselves require that equipment which is worn out or destroyed shall be replaced with equipment of "equal efficiency and capacity." (The mortgages are in the record as Debtor's Exhibits 64-68.)

The Debtor is in default with respect to replacement of equipment. As of June 30, 1933, the cost to the Debtor of fulfilling its equipment replacement obligations under the Terre Haute lease was $5,030,598 (Record page 183), which was reported to have increased to $6,832,556 as of December 31st, 1936.

Mr. Burgess: That was reported to you by the Debtor, was it?

The Witness: Reported to me by the Debtor and 2820 as shown in Exhibit No. 168 filed in this proceeding this morning, as of December 31, 1937, the deficiency with respect to equipment replacement obligations amounted to $7,106,149.

The Debtor "as a part of this indenture, and of the consideration therefor, does hereby expressly assume to make due and punctual payment of both interest and the principal * * *" of all the leased company bonds. (Exhibit 63, Art. 3, Section 1, page 10.)

The Debtor under the terms of the lease has guaranteed the interest on the Terre Haute Income Bonds without regard to whether or not there is income of the leased properties sufficient therefor. (This is shown in Exhibit 63, Art. 2, Sec. 2 (e) (4) and Exhibit 1, p. 6, Footnote 1.)

The lease permits, however, extension or refunding of the guaranteed bonds at maturity.

The Debtor under a continuation of the lease will be faced with maturities to be paid, extended or refunded as follows:

	The Bedford Belt 1st, 5's on July 1, 1938	$ 250,000
	The Southern Indiana Ry. 1st 4's Feb. 1, 1951	7,287,000
2821	C. T. H. & S. E. Ry. 1st Ref. 5's Dec. 1, 1960	$ 8,058,000
	C. T. H. & S. E. Ry. Income 5's Dec. 1, 1960	6,336,000
	Bonds in Hands of Public	$21,929,000
	And in addition, C. T. H. and S. E. Ry. 1st & Ref. 5's 1960 which are owned by Debtor	1,515,000
	Total Outstanding in the hands of the public and owned by the Debtor	$23,444,000

Q. (By Mr. Burgess.) Now, what about the physical valuation of the property of the Terre Haute as valued under these mortgages, based upon the reports of the Interstate Commerce Commission as to cost of reproduction new and less depreciation?

A. The comparison of the Terre Haute Bonds outstanding and the value of the Terre Haute property pledged under the mortgages is as follows:—

Total Terre Haute Bonds Outstanding $23,444,000 Interstate Commerce Commission Bureau of Valuation—

Q. That is, you are referring to the—that is physical valuation when you say that, are you?

A. As shown in the valuation report.

Q. Yes.

2822 A. By the Bureau of Valuation, heretofore referred to and which shows, December 31, 1935:

Cost of reproduction new less depreciation	$19,357,027
Including equipment subject to C. M. St. P. & P. Equipment Trust E December 31, 1935 Value of Lands and Rights	1,323,087
Total Value	$20,680,114

Mr. Burgess: When you say total value, Mr. Walker, you are referring only to these elements of value, I take it?

The Witness: Total value of the elements consisting of cost of property, based on cost of reproduction new less depreciation, and the value of lands and rights.

Q. (By Mr. Burgess.) What is that total?

A. $20,680,114.

Q. That compares with the total bonds outstanding that you previously noted of $23,444,000?

A. That does; leaving an excess of bonds over the value of the properties specified of $2,763,886, but in this property there is included the depreciated values of the Equipment subject to the Chicago, St. Paul and Pacific
2823 Trust E, against which there are outstanding $1,521,000 of Equipment Trusts.

Therefore, the total deficiency in these values in regard to the bonds is $4,284,886. That is in regard to the bonds and equipment trusts outstanding against the property.

Q. Now, does this lease of the Terre Haute make any provision for abandonment of lines by the Debtor?

A. No provision is made in the lease for abandonments and therefore the Debtor is obligated under its terms to continue to maintain and operate the property until July 1, 2920.

Q. What about the earnings on the lines of the Terre Haute?

A. The Terre Haute is primarily a coal carrying railroad; practically no passenger service is operated.

The Trustees' report states that before the lease to the Milwaukee, "the Terre Haute was a small railroad which could not and did not get much longhaul business." (Pr. Rec. Vol. 3 p. 1803.)

Exhibit 139 shows what a controlling part the transportation of system material and especially system coal, is of the railway operating revenues of the Terre Haute.

Mr. Burgess: I might explain, Mr. Director, that the reason for this discussion that we are now
2824 engaged upon, is justification of the treatment accorded the Terre Haute Bonds in our plan.

The Witness: At the bottom of Exhibit No. 139 is a note that the tons of Milwaukee coal hauled for the year 1936—by Milwaukee coal meaning coal for the use of the Debtor's railroad, and primarily for use on the general mortgage lines—2,049,747 tons. And under railway operating revenues is the item "Freight revenue" for hauling of Milwaukee Company material at tariff rates, coal $2,106,406; other than coal $102,600; amounting to $2,209,000 of revenue for hauling of company material at tariff rates, with only $5,253,877 of revenue coming from commercial business.

In addition to the revenuees coming directly from the hauling of the company coal and material, a very sub-

stantial revenue is derived from commercial coal dependent upon purchase of coal by the Debtor from mines on the Terre Haute.

I discussed this matter with representatives of the Debtor. Personally I did not feel that it was a matter that needed discussion in order to arrive at the conclusion that where a railroad company was buying large amounts of fuel from mines on its lines that those mines would as
2825 a matter of business, just ordinary sound business, ship over the lines of that railroad coal where the route by such shipment would not be longer or the route higher, coal that neither the consignee or the consignor directed specifically the routing, but primarily the consignee had made no request as to how it would be routed. That is just sound, ordinary business sense, it seems to me, to reach the conclusion that mines with that very desirable business, namely the steady demand for the railroad's coal located on the lines of the Terre Haute would route over the lines of the Terre Haute only shipments where the routing had not been specified by the consignee.

It seems very doubtful to say the least that the mines on the Terre Haute have coal reserved sufficient to last for 982 years, the unexpired term of the lease. If the Terre Haute is no longer part of the system, there is no reason to suppose the reorganized company would continue to buy its coal from mines on the Terre Haute as the Milwaukee did not do so prior to the leasing of the Terre Haute, or as the Debtor is compelled to buy more and more of its coal requirements from mines not on the lines of the Terre Haute as their reserves become exhausted, so that if the reorganized company does not purchase for one rea-
2826 son or another a substantial portion of the coal requirements of the present General Mortgage lines from mines on the Terre Haute and the Terre Haute loses the revenue from that business, as well as the commercial coal revenue dependent upon the purchase of coal from these mines by the reorganized company, the revenues of the Terre Haute, I believe, would be so seriously impaired that there is serious doubt whether its net income would meet the present rental.

Exhibit 139 shows Income Available for Interest Charges for the Terre Haute Lines for the year 1936 or $2,990,126. The revenues, expenses, and net income were determined for the purpose of showing the value of the Terre Haute to the Debtor's system and Exhibit 139 is not a division of

earnings between mortgage lines on the assumption that all of mortgage lines continue to be operated as a part of the Debtor's system. That is a matter of record in this case.

In arriving at the figure of $2,990,126, Exhibit No. 139, for net income available for interest charges of The Terre Haute two important departures are made from the formula for the apportionment of earnings between Mortgage lines, which are in effect or usually considered where it is on a system basis;

(1) the allowance to the Terre Haute of tariff 2827 rates for the haul of company coal and other company material with a corresponding charge for the haul of Terre Haute Company material over other System Lines and

(2) Use of per diem charges as between foreign roads, that is, on equipment.

I might say there, in connection with that, discussing the per diem charge on equipment, and particularly freight equipment on the Terre Haute Road, no charge was made in Exhibit No. 139 for empty freight cars, that is, coal cars owned by the Milwaukee but on the Terre Haute Lines up to a supply of four days coal loadings, that being quite a common practice, either allowing that number of days, or possibly in some instances more between railroads, where the cars of one railroad are loaded on another railroad for shipment to come back over the lines of the owning railroad, or the railroad owning the cars. But that is quite a departure from the formula that are quite generally, or at least in many cases used with respect to the charges for the use of equipment.

To justify the claim that the Terre Haute should be credited with tariff rates on haul of company coal, and that per diem charges as between foreign lines should
2828 be used requires the assumption that the Terre Haute is being operated as a separate railroad, while the other income account items are treated in Exhibit 139 on the assumption of operation of the Terre Haute as a part of the system.

Furthermore no consideration is given to the fact that prior to leasing the Terre Haute the Milwaukee did not purchase its coal from the mines on the Terre Haute and that if the Terre Haute, as a separate railroad, lost the company coal as well as the commercial coal dependent on purchase of the company coal from mines on the Terre

Haute lines, it is doubtful if the net income would be sufficient to meet the Terre Haute's interest charges.

On the assumption that the Terre Haute is operated as a part of the Debtor's system, the net income available for interest charges of the Terre Haute for the year 1936 would be $2,040,187. This is shown on Exhibit No. 157, as item 3, "Income Available for interest charges, cost of service basis. And from this item there should be deducted interest on Terre Haute Bonds held by Public, interest on Terre Haute Bonds pledged and interest on Equipment trust E, Total $1,164,860,, leaving a net income on cost of service basis for rental and interest on Equipment Trust E
2829 $875,327, as shown on Item 7 at the bottom of the page, Exhibit No. 157.

It is, therefore, evident that based on the level of freight and passenger rates, the cost of materials and supplies, scales of wages and pension and unemployment taxes in effect June 1937, and so long as the Terre Haute is operated as a part of the system and, the mines on the Terre Haute can and do ship approximately the same volume of coal over the Terre Haute as in 1936, the Terre Haute will earn its interest and have some margin over.

The elements, among others, relating to the Terre Haute Lines which have led to the conclusions later to be stated, are the following:

(a) The inability to abandon property covered by the lease.

(b) The lease, extending as it does for 999 years, coupled with the ownership of 97 per cent of the stock of the Lessor by the Lessee, makes the lease in effect a fictitious thing. The present reality is ownership.

(c) The vacancies in equipment, which are in default both under the lease and under the mortgages outstanding on the leased properties, aggregating as they do $6,832,556 as of December 31, 1936. Shown on Exhibit 168 introduced into the record this morning.

2830 (d) The refunding operations necessitated by the early maturities of the Terre Haute mortgages under the terms of the lease.

(e) The high ration of funded debt to property values.

(f) The dependence for so large a part of its revenues upon continuing as a part of the Milwaukee System.

(g) The effect upon the soundness of the capital structure of the Reorganized Company of the uncertainties created by this 999 year lease of a coal railroad and by

continuing the Terre Haute mortgages and the bonds outstanding thereunder as obligations of the Reorganized Company.

Q. (By Mr. Burgess.) Now, what was your conclusion, in the light of those considerations?

A. I concluded that the Terre Haute Lease should be terminated and the property of the Terre Haute and Southeastern Railway System should be merged or consolidated with the properties of the Debtor under the reorganized company; that the mortgages of the Reorganized Company should extend to the properties of the Terre Haute System; and that the bonds having a lien on the Terre Haute System should be provided for on an equitable basis in new First Mortgage Bonds of the Reor-
2831 ganized Company in the manner hereinafter described.

Q. The Committee by approving the Plan has recorded itself as in harmony with those views that you have just expressed?

A. That is so. All of these various matters have been discussed with the Committee, views and reasons given. Each member of the Committee has a complete set of the Exhibit in this case and they have in their organizations, almost every one of them, a Department which make a practice of and whose business it is to examine and analyze statistics and information of this character so that at the Committee Meetings these various provisions which are in the Plan were discussed and when a plan was approved by the Committee it was approved as a result of discussions and this meeting with the various members of the Committee informed to the extent that the information was contained in the Exhibits and to the extent that other information was conveyed to them or opinions expressed with an explanation as to how those opinions or views had been arrived at.

Q. Now, what have you to say as to the treatment of present creditors and stockholders as is accorded in the Plan of Reorganization, Exhibit No. 175?

2832 A. I am firm in my conviction that the relative priorities must be preserved to the greatest degree possible in the light of the actualities and a measure of compensation provided when sacrifices of position are required.

In conformity with these convictions, Equipment Trust Obligations, covering equipment essential to the operation

of the system, and Loans secured by ample collateral and Mortgage Debt amply secured are accorded preferential treatment in the Plan over Mortgage Debt not amply secured and over General Creditors; Mortgage Debt by reason of its priority is accorded preferential treatment in the Plan over General Creditors to the greatest extent considered practicable and a measure of compensation is provided for such sacrifices of position as it was believed to be necessary; and provision is made for the participation of General Creditors to the extent permitted by the limitations imposed by a sound capitalization which in this instance does not permit of participation by the present preferred and common stock.

Q. Now, will you please describe in a general way the securities of the reorganized company which this plan contemplates?

A. Before I do that, if I may, I would like to men-
2833 tion what it appears to me to be the sacrifices or at least the major sacrifices that have been necessary in this case to impose upon the secured creditors, and particularly to impose upon the creditors which now hold fixed interest bearing mortgage obligations.

The creditors, or at least some of the creditors, that is those creditors whose claim is not amply secured under the plan, have been required to accept part fixed interest bearing obligations with a first mortgage lien. The General Mortgage Bonds and the Consolidated Bonds of the Milwaukee and Northern Railway each receive 60 per cent of the fact of their claim in fixed interest bearing obligations, First Mortgage lien, but the balance of their claim is satisfied in second mortgage contingent interest bearing obligations, to which is inserted or included in the plan as one of the vital provisions of the plan, in my opinion, an obligatory improvement and betterment fund, that is inserted as a wedge before interest becomes payable upon the contingent interest bonds, Series A or Series B.

Q. That is a sacrifice that is asked of these General Mortgage Bondholders under this plan, is it not?

A. That is one of the sacrifices. In addition, the In-
come Bonds are not fully cumulative. The Preferred
2834 Stock is not fully cumulative. In fact, the Preferred Stock is not cumulative at all, and so these provisions, which will later be developed in discussion with those particular provisions in the Plan, represent sacrifices which through necessity, as I see it, to attempt at

least to preserve a sound capital structure, these creditors are called upon to accept.

Q. Now, does the plan provide some measure of compensation for those sacrifices?

A. Yes, it does, the plan provides some measure of compensation.

Q. And that is a matter that you will discuss later?

A. And that matter will come in the discussion which I will read in connection with these various provisions which have been included in the Plan as provisions to be included primarily in the First Mortgage, new First Mortgage, and in the General Mortgage indentures.

Q. Now, will you give a brief description of the type of securities that are provided in this plan for the reorganized company to issue?

A. The capitalization of the reorganized company is shown in Table A, page 18 of the Plan.

Q. Page 49, Mr. Walker?

A. Page 49 of the Plan, and also in condensed 2835 form, on page 18.

This consists of Equipment Trust Obligations, first mortgage 30 Year 4 Per Cent Fixed Interest bearing Bonds, General Mortgage Series A Fifty Year 4½ Per Cent Income Bonds, General Mortgage Series B, Sixty Year 5 Per Cent Income Bonds, Participating Non-Cumulative Preferred Stock and No Par Common Stock, stated at $100 per share for illustration.

The Equipment Trust Obligations to be outstanding as of July 1, 1938, in the amount of $30,516,671, exclusive of Equipment Obligations that may be issued prior to the effective date of the Plan, will remain undisturbed under the Plan.

First Mortgage Bonds (as shown on pages 19 to 25 of the Plan) will be unlimited in authorized principal amount subject, however, to the mortgage provisions, with new 4 Per Cent First Mortgage Series A 30 Year Bonds in the amount of $132,414,000 to be issued and distributed at July 1, 1938, the date of the consummation of the Plan, as now assumed; and $10,000,000 of additional First Mortgage Series A 4 Per cent Bonds will be issued and held in the treasury as an Emergency Fund under restrictions prescribed in Article 4-B of the Plan, pages 20 and 21.

Now, the reason, controlling reasons for issuing
2836 this $10,000,000 of Reserve Fund Bonds rather than to have in the treasury large amounts of cash coming

from the sale of additional First Mortgage Bonds at reorganization which thereafter would be outstanding, drawing fixed interest, is that in case of an emergency I believe it would be in the interest of all creditors that rather than have the road go into bankruptcy by reason of being unable, temporarily, to meet its obligations, or to meet some expenditures which were forced upon it and over which it had no control, for such as for instance, separation of grade, elevations of track, or other matters of that kind, that there should be available to the Board of Directors of the Corporation a fund in the form of First Mortgage Emergency Fund Bonds that could be issued to meet that emergency, and that the Emergency Fund Bonds could be replaced at once through the issuing of an additional $10,000,000 of bonds without the requirement which appears on page 23, that income available for interest must represent at the time of issuing additional First Mortgage Bonds—

Director Sweet: As I understand it, Mr. Walker, you have not included this $10,000,000 of Emergency Fund First Mortgage Bonds in your total of $640,000,000?

The Witness: No, sir, I don't see where, when the
2837 road comes out of bankruptcy, there will be an emergency that the reorganized company must immediately or very shortly meet.

Director Sweet: What you are proposing is the immediate capitalization of $640,000,000 and if there is an emergency and things get bad, then the capitalization of $650,000,000?

The Witness: Yes, sir, but there is this further provision with respect to replenishing the fund, that while the earnings restriction of 1½ times earnings, interest on all of the First Mortgage Bonds outstanding and to be issued as well as on all other debt prior to or standing on a parity with the First Mortgage Bonds must be sufficient to pay those fixed charges 1½ times, yet the additional $10,000,000 of First Mortgage Bonds are to be issued to replenish the Emergency Fund cannot be issued unless there are net additions and betterments balances which could be used for the issue of First Mortgage bonds, available for issue.

In other words, the only lessening of the restrictions in order to replenish the fund is that for replenishment wants the provision of 1½ times earnings would not apply, the
balance can only be issued against a net balance for
2838 improvements and betterments representing additional property.

These new First Mortgage Bonds are to be issued to satisfy in full the claims of the Reconstruction Finance Corporation and the Railroad Credit Corporation;

To satisfy in full the claims of the Leased Company Bondholders that is par for par;

To satisfy in full the claims of the Milwaukee and Northern First Mortgage Bondholders;

To satisfy 60 per cent of the claims of the Milwaukee and Northern Consolidated Mortgage Bondholders and 60 per cent of the claims of the Chicago, Milwaukee and St. Paul General Mortgage Bondholders.

No sinking fund is required for the Series A Bonds, it being felt that with the bonds, so small an issue of bonds, fixed interest bearing obligations, the interest on which would be covered 1½ times, with the minimum average earnings reasonably to be expected, that the sinking fund should not apply or be required on the present series of First Mortgage Bonds which are to be reissued at reorganization, but that future Series of Bonds would carry such sinking funds as the Board of Directors might determine.

With regard to the security, all property and assets owned on consummation of the plan, or thereafter
2839 acquired with suitable provision for merger and consolidation; now, the reason for that, as I see it, from the viewpoint of not only institutional investors, but from the viewpoint of individuals who invest their money in what at the time of the investment are First Mortgage Bonds upon the main line and heart of a railroad system will be protected throughout the life of the bonds in the relative position of those bonds with respect to other bonds that may be issued or become liens upon the system.

I have had occasion to observe that lines have been built as a part of the system which have no terminals, but merely are what might be called back-lines over which there is merely bridge traffic, or bridge line traffic, pass-over traffic, and that traffic is diverted from the lines upon which the underlying mortgages have a lien. Such diversion materially affects the value of the underlying mortgage by taking away from it the line haul traffic and leaving it with the expense of terminals, sometimes terminals on both ends of this bridge traffic. Such lines on an ordinary pro-rate basis have shown earnings due to their heavy traffic volume that is diverted over them and without consideration

of the fact that it has been taken from the other lines
2840 which at the time these back lines were built furnished the credit and furnished the traffic upon which the credit was based for the construction of the lines, as they could not have been built or financed as separate and independent railroads and yet after their construction they weakened the investment position and the credit of the underlying bonds which institutional investors and individual investors in making the investment relied upon their status being continued until maturity.

So I included in the mortgage provisions, and these provisions have been thoroughly discussed at the meetings, committee meetings, there is included in the provision, on page 20, with respect to the security of the bonds, or rather security under the mortgage, the general after-acquired property clause, modified only as shown to prevent conflict or embarrassment in the event of merger or consolidation. That I believe, is an essential provision and should be included in the mortgage if institutional investors are to continue to invest in railroad mortgage bonds on the basis of income yield to maturity, on the basis of holding the bonds to maturity, and at maturity receiving payment of the principal amount payable to them, or being accorded the privilege, if they so desire, to accept Refunding Bonds in their place.

2841 It is to be observed that there is a limitation under which additional bonds can be issued, as shown on page 21, Paragraph 2, (a). For 75 per cent of the net balances for improvements, extensions, betterments and the acquisition of additional property (except equipment), acquired after reorganization, less retirements, to the extent of 75 per cent of the net cost thereof.

It has been quite customary in the past, quite customary in the past and under the present railroad mortgages is still quite customary, to issue bonds for 100 per cent of the cost of additions and betterments. In some instances the mortgage does not require that these be issued against net balances. However, the Commission in approving of the issue of additional bonds has required that, in many cases at least, and I believe it to be the policy of the Commission that the bonds can be issued only against net balances.

A provision also is included under which bonds may be issued for 75 per cent of the cost of new equipment, with the term not exceeding fifteen years, or the life of the

equipment, less than fifteen years, and possibly with some types of equipment and motive power which are now
2842 being used on the railroads, with the present knowledge as to their life, the life might be assumed properly to be less than fifteen years, if obsolescence is also taken fully into account.

However, if bonds are issued against new equipment, with the time not exceeding fifteen years, a positive sinking fund is required to retire these bonds within fifteen years.

Now, the reason for a provision of this character is that I have had occasion to see and know of instances where bonds which our company holds have been issued for equipment, against equipment, and those bonds are of maturity much longer than the life of the equipment, and in some cases the bonds have been issued against equipment that was fifteen or sixteen years old, namely; after the Equipment Trusts had been paid off so that the mortgagor railroad had title to the equipment.

The purpose of the provisions which appear in the mortgages, or proposed mortgages in this plan, the purpose is not to embarrass or unduly restrict the management of Board of Directors, those engaged in the operation of the property in proper operation and development of the property, but the purpose is to afford to investors, whether individual or institutional the measure of protection which I believe they are entitled to have and preserve the
2843 relative position and security of the bonds which they may invest in during their life.

The other provisions in the General Mortgage and in the First Mortgage, the new First Mortgage, and in the new General Mortgage which are substantially common to both and that I would like to direct attention to, are the provisions with respect to reserve and retirement fund, on pages 23 and 24, and the additions and betterments fund on pages 24 and 25 of the Plan.

The Plan provides that the First Mortgage and the General Mortgage will contain covenants substantially to the effect that each year there will be paid into a Reserve and Retirement Fund such amounts charged against depreciation of equipment, with a minimum charge of $5,500,000 as the Interstate Commerce Commission shall require or permit, or else the payment shall be 2 per cent of the gross revenues, whichever is the larger.

These payments are made and required to be made under

the Plan if earned, prior to the payment of any interest on the Income Bonds.

Q. (By Mr. Burgess.) Mr. Walker, doesn't the 2 per cent relate to the Additions and Betterments Fund and not to the Reserve and Retirement Fund; I may be confused about it.

2844 A. That is correct. I am consolidating the two funds in this statement, and I neglected to so state. If I may make a clarification of the statement:

The Reserve and Retirement fund, the mortgage provides that there shall be paid into the Reserve and Retirement Fund a minimum of $5,500,000.

Q. Now, into the Additions and Betterments Fund?

A. As a charge against depreciation of equipment, or such other greater charge as may be permitted or required by the Interstate Commerce Commission, and there shall be paid each year into the Additions and Betterment Fund the large of 2 per cent of railway operating revenue or a minimum of 2½ million dollars out of earnings, before making any payment on account of contingent interest.

Q. Now, that is one of the wedges that you referred to a while back, is it not?

A. That is; that comes ahead of the interest on the income bonds or General Mortgage bonds and is obligatory, if earned. If it is not earned, of course, it is not obligatory and it is not cumulative.

Now, under the Interstate Commerce Commission's classification of Accounts Retirements of Road are charged to Maintenance of Way and Structures, and in the Report.

Committee's Exhibit No. 9, which will be later pre-
2845 sented—

Mr. Burgess: That has been marked Exhibit No. 185, Mr. Walker.

The Witness: Exhibit No. 185, it is shown that the gross capital expenditures on roadway and existing equipment; salvage recovered from road and equipment retirements, road retirement charges to operating expenses; and net cash requirements by years from 1924 to 1937, both inclusive—instead of, it is shown, I should say this report shows, or it is shown in this report.

The road retirements charged to operating expenses for the six year period 1925 to 1930 averaged $1,277,891. for the five year period 1931 to 1935 average $995,292. Salvage recovered from road and equipment retirement av-

eraged $1,301,876 for the six year period 1925 to 1930, and averaged $1,151,208 for the five year period 1931 to 1935.

In the future average normal year the funds available out of earnings for payment on equipment and additions and betterments against which no additional securities can be issued, are as follows:

Additions and Betterment Charges	
2 Per Cent of $126,900,000	$ 2,598,000
2846 Retirements included in Maintenance of Way and Structures, Committee's Forecast estimated at	1,000,000
Salvage 1931-1935 Average	1,150,000
Depreciation on Equipment included in Committee's Forecast—	6,014,000
Total Funds Available Future Average Normal Year	$10,762,000
In addition Cash will be paid into Sinking Funds (Exhibit C, Page 55 of the Plan)	566,000
Therefore, total funds which will be put back into the Property or the equivalent in Future Average Normal Year against which no additional securities can be issued will be	$11,328,000

Now, one of the important features of this Reserve and Retirement Fund is that the payments must be made into the funds, and this fund must be segregated from the general fund and devoted only to the purposes which are shown in the plan and in the order of priority as shown on pages 23 and 24.

Now, in addition to this $11,328,000, and the reason I am going into this matter to the extent that I am is that it goes to the question of whether under the plan there
2847 will be sufficient funds to continue to operate the property economically, serve the public, and keep in step with the advances that are and will be made in the art of transportation.

In addition to this $11,328,000 there will also be available $888,000 less Federal Income Taxes and Surtaxes on Undistributed Profits after interest, Additions and Betterment Fund and Sinking Fund payments.

Now, I do not want to contend that there will be, as the laws now stand, any very large proportion of that $888,000 that would be available for improvements and betterments.

I do not know what that proportion would be, because of the fact that we have an improvement and betterment fund of two and a half million dollars which possibly would not be a deduction in determining taxes, and we also have a sinking fund of $566,000, which probably would not, or might not be a deduction. But at least, we would come down through in the average normal year with the $11,382,000 available, and such additional amount as there might be left out of the $888,000, after paying taxes.

Now, as I see the situation, comparatively few major additions to way and structures will be required even if
the volume of traffic increases beyond that estimated
2848 for the future average normal year, in which event,
however—that is, if the traffic increases as I have estimated—the payments into the additions and betterments fund will be larger, these estimates being based upon 2 per cent of the gross revenues, the amount available after interest, Additions and Betterments Fund and Sinking Fund payments will be larger and any deficiency can be made up from the Reserve and Retirement Fund unappropriated balance available for such purpose, if any, otherwise by funds derived from the issue of additional securities.

Now, one of the primary reasons why the preferred stock in this plan was not made cumulative was that the funds available after the payment of interest, after the obligatory A. and B. Funds, and after the payment of contingent interest, and after the sinking fund on the income bonds, would be free of any restriction for the Board of Directors to exercise their judgment as to what use should be made of the balance in the best interests of the property and of the public. For that reason no cumulative figure is included in the provisions with regard to the preferred stock, under this plan.

The funds for betterments should be ample as a
2849 large proportion of their cost is generally chargeable
to operating expenses included in maintenance of way and structures and the estimate for the future normal year.

There is an excess of railroad facilities, as I see it, in the territory served by the Debtor and by pooling, by joint use of facilities, and coordination in addition to direct economies of operation, total expenditures for additions and betterments should be reduced below the experience of the previous years. Not only the experience of

previous years, in my opinion, for this company, but below the experience in previous years for the railroads competitive to this company, that are operating in this same general territory, which has resulted in either duplication of facilities or excess capacity, and of the facilities which these competing railroads possess.

Now, I would like to call your attention at this time to the statement that these requirements can be financed to the extent found necessary after exhausting available funds in the Reserve and Retirement Fund through the sale of Equipment Trust Certificates, the liquidation of which should come from the resulting increase in
2850 economy of operations, otherwise the additional investment would not be justified.

I believe that funds coming from depreciation on equipment should be used from time to time as available in connection with the purchase of new equipment to the full extent that funds are available, after a reasonable provision is made for what requirements can be seen in the near future. I do not think that the amount of cash payments on the purchase of equipment where Equipment Trusts are issued should be frozen at 25 per cent. I think that if the funds are available and looking at the picture as we see it, and with these equipment depreciation funds segregated, large payments should be made and eventually the percentage of Equipment Trusts issued against the cost of new equipment, which is largely replacement of equipment, should be substantially greater than the 20 or even 25 per cent that is now customary.

I believe that if the depreciation account, as recommended by the Commission years ago had been put in effect on the railroads and the funds coming from depreciation of all depreciable property had been used for replacement, the picture of the railroads with respect to corporate structure today, many of them would be materially better than it now is. That is my personal
2851 opinion.

It is therefore, believed that the Reserve and Retirement fund and the Additions and Betterments Fund under the conditions and restrictions provided in the plan, to which attention will now be directed, will provide amply for the ordinary needs of the property under conservative financial policies and efficient management.

Q. (By Mr. Burgess.) Is there anything further that you want to say about the Reserve and Retirement Fund

and the Additions and Betterments Fund, in that connection, or have you covered it as you have gone along?

A. I think that the primary purpose of the Reserve and Retirement and the Additions and Betterments Funds have been explained and that the particular provisions as set forth on pages 23, 24 and 25, with the explanation I have attempted to make, will be self-explanatory and reasonably understandable.

Q. (By Mr. Burgess.) Then can we turn to the treatment of existing securities as provided in the Plan, Mr. Walker?

A. Turning to page 35 of the Plan, Article V, Treatment of Existing Securities.

With regard to the treatment of arrears of interest
2852 in the Plan: All interest on debt accrued and unpaid up to the time of the plan is made effective (assumed for the purposes of the Plan to be as of July 1, 1938) is added to principal in fixing the amount of the claims and is accorded the same treatment in the distribution of new securities as the principal to which it relates. It is, in my opinion, of vital importance to institutions investing their funds on the basis of yield to maturity, and also to individuals investing funds for income to them to maturity, that this fundamental principal should be preserved and made effective, otherwise the relative value of underlying bonds to junior bonds and stock is undermined and impaired.

Interest when paid becomes principal to the recipient of such payment and the relative certainty of payment of principal at maturity and of uninterrupted payments of interest when due, minimizing the possibility of loss and permitting prompt investment of funds so received, are in my opinion the governing factors which justify investment in underlying securities at comparatively low yields rather than in junior securities at higher yields but with greater risk of loss of principal and less assurance against defaults in interest.

2853 If interest accrued and unpaid during bankruptcy is not accorded the same treatment as the principal to which it relates, the losses and penalties imposed on each class of interest bearing securities redounds to the benefit of all junior classes of securities and manifestly the stockholders receive the accumulated benefits of all the losses and penalties imposed upon each class of security holders.

Manifestly if accrued and unpaid interest is not accorded the same treatment in the distribution of new securities as the principal to which it relates, the larger this item of interest becomes the greater the losses of the creditors, the greater the benefits or gains accruing to the stockholders and the greater the tendency to prolong bankruptcy.

Those are my views with respect to this item, and the importance of this item of according to interest the same treatment as the principal to which it relates.

Director Sweet: Well, that is very good argument, Mr. Walker, but I do not know that we ought to go into that. I think we should confine this record more to statements of fact in the case and let Mr. Burgess argue some of those questions.

Mr. Burgess: I cannot do it as effectively, Mr.
2854 Director.

Director Sweet: He can do it pretty well when his turn comes.

Mr. Burgess: And furthermore I did want Mr. Walker to cover what he thought were both items of public interest and private right.

Director Sweet: Yes, but we ought to try to limit as much of the argument as we can, Mr. Burgess.

Mr. Burgess: We will try to curtail it, Mr. Director.

Q. (By Mr. Burgess.) Mr. Walker, the claims that are not affected by the Plan are set forth on pages 35 and 36, are they not?

A. They are, and I believe that they are clearly stated and that nothing constructive can be added to the statement as it is included in the Plan.

Q. Now, is there anything that you want to add to the statement on page 36 as to the securities that are to remain undisturbed as to lien and interest, but to be extended in part as to principal, that is, the equipment trust?

A. It is my opinion that this is a fair and equitable statement for these particular equipment trusts under the conditions existing. This is the treatment which under the
2855 stand-by Plan has been accorded since June 30th, 1935. My feeling is, in connection with them, that so long as the interest on the equipment trust is paid, and the installments on the extended basis are also promptly paid at maturity, that those extended equipment trust certificates, or the certificates under this plan of installment payments are sound investments and the treatment accorded is fair and equitable.

Q. Now, what have you to say about the treatment of the short term debt?

A. The Reconstruction Finance Corporation will be alloted $13,210,463 in principal amount of first mortgage bonds, Series A, in satisfaction of the principal, interest to be currently paid with appropriate adjustment upon consummation of the Plan, of its claims consisting of the claim of $11,499,463 on account of loans to the Debtor, collaterally secured and $1,711,000 as assignee of claims of Federal Emergency Administration of Public Works on account of loans to the Debtor.

The collateral pledged under these loans is shown in Exhibit No. 172, as to the Reconstruction Finance Corporation Loans and the Railroad Credit Corporation Loan.

Director Sweet: Do you think those Reconstruction
2856 Finance Corporation Loans are adequately secured?

The Witness: Yes, sir.

Director Sweet: And for that reason you propose to give them 100 per cent of the amount of principal and interest in new First Mortgage Bonds?

The Witness: Yes, sir; that is so.

Director Sweet: That is true also of the R. C. C.?

The Witness: That is true.

Director Sweet: Loans?

The Witness: In my opinion.

Q. (By Mr. Burgess.) Now, it is proposed to have the collateral surrendered and cancelled, is it?

A. It is proposed that the collateral for the Reconstruction Finance Corporation Loans and the Railroad Credit Corporation Loans will be surrendered and cancelled.

Q. Now, is there anything further that you want particularly to say about that short term debt, there seems to be no criticism of that treatment that has yet been voiced in any event.

A. There was only one item that it seemed to me it might be well to direct attention to, and that is the value that is pledged under the First and Refunding Mortgage Bonds which are pledged in turn under the Reconstruction
Finance Corporation loan. But that item will be taken
2857 up later in connection with the First and Refunding Mortgage Bonds.

The estimated income for the First and Refunding Mortgage Lines and the treatment to be accorded to the so-called 5's of '75 by reason of the fact that the 5's of '75

have a second lien upon the lines subject to the first lien of the first and refunding mortgage, which has a primary, a first lien upon the lines west of Mobridge, at the Missouri River, and upon some scattered ends of lines east of the river.

Q. (By Mr. Burgess.) Now, turn to the matter of the leased company mortgages, on pages 37 and 38 of the Plan, there is shown the treatment which is to be accorded to the holder of such bonds, is it not?

A. Yes.

Q. Now, have you anything additional to say concerning that general subject matter over and above that statement there and your discussion this morning?

A. There are one or two other suggestions in connection with this, and facts as I see them that should be brought out.

It has been previously shown herein that for the year 1936 the Terre Haute operated as a part of the System, had net income after charges of $875,000 and that this net income, as well as its value to the system is de-
2858 pendent upon the ability of the Debtor to buy the coal for its general mortgage lines from mines on the Terre Haute.

It is assumed that the mines on the Terre Haute will continue to be operated for a considerable period of time and that as from time to time these mines become exhausted economies resulting from retirals, pooling, joint use of facilities, et cetera can be made effective if the Reorganized Company is not burdened with the lease, and during such period of time the reorganized company should enjoy the benefits of the Terre Haute's inclusion in the system and be able to amortize necessary retirements.

That, as I see it, is the real justification, not only justification but almost impelling necessity of taking the Terre Haute into the System and as portions of its line become no longer profitable so that they should be abandoned, that this abandonment can be worked out and the cost or value of the property retired can be amortized during the period that the Milwaukee Road or new System or the Reorganized Company can continue to enjoy the benefits of the coal traffic it would gather over the Terre Haute Lines.

Q. Now, Mr. Walker, can you turn to the general subject of the treatment that is accorded in this Plan to the
2859 various mortgage bonds of the Debtor and not only explain the treatment insofar as it has not already

been explained but present what in your opinion is a proper justification of that treatment.

A. In regard to the Debtor's mortgage bonds and by "Debtor's Mortgage Bonds" I refer to the bonds so listed in Exhibit A, page 49, as Debtor's Mortgage Bonds. They are there listed as Debtor's Mortgages.

The Debtor offered testimony and introduced Exhibits in support of the allocation of revenues and expense for the year 1936 to the following mortgage districts:

(1) Terre Haute Southeastern Railway Lines,

(2) Milwaukee and Northern Railway Lines,

(3) Chicago, Milwaukee and Gary Railway Company First Mortgage Lines, and

(4) Chicago, Milwaukee, St. Paul and Pacific Railroad Company, First and Refunding Mortgage lines, which is shown on Exhibit No. 181, offered by this Committee, upon which are appropriate references to the Debtor's Exhibits, and from which these figures were derived and this Exhibit prepared.

A summary statement is also included or shown on the Exhibit introduced by the Committee at this hearing, Number 180.

2860 No direct allocations of revenues and expenses for the year 1936 to (5) The Chicago, Milwaukee, St. Paul and Pacific Railway Company General Mortgage Lines was made, but the earnings of this mortgage district were assumed by the Debtor as system revenues and expenses less the sum of revenues and expenses directly allocated to each of the Four Districts above described.

As previously stated, the revenues and expenses so arrived at for the General Mortgage Lines are shown on Exhibits 180 and 181, entitled "Summary of Allocation made by the Debtor of the actual System Earnings for the year 1936 to Mortgage Districts, in designated Exhibits, with various adjustments made by the Debtor separately shown, together with interest requirements," and are shown in detail in Exhibit No. 181, from which the summary was made.

Q. Now, can you turn of the treatment of the Milwaukee and Northern bonds, Mr. Walker?

A. The Debtor allocated revenues and expenses for the year 1936 to the Milwaukee and Northern Lines in Exhibits 141-142 without separation between lines subject to the first liens of the First Mortgage and the Consolidated Mortgage, that is the lines south and north of Green Bay,

Wisconsin. The method used in arriving at the earn-
2861 ings of these lines for the year 1936 is described in Exhibit 142.

It should be noted among other things:

(a) That on freight traffic carried jointly by other system lines and the Milwaukee and Northern Lines the Milwaukee & Northern was given the customary division between foreign railroads applicable in this territory, viz.; a mileage prorate with a 25 per cent minimum to the short line, except that the Milwaukee and Northern did not participate in the revenues accruing from hauls beyond Chicago, Minnesota or Missouri River Gateways;

(b) That on business originating or terminating at Milwaukee or delivered to foreign roads at Milwaukee on the terminal lines upon which the General Mortgage is a first lien, moving from or to the Milwaukee Northern, all of the freight revenues were assigned to the Milwaukee and Northern, less published switching tariffs charged foreign railroads;

(c) That while items (a) and (b) are treated on the basis of the Milwaukee and Northern being a foreign road, other items such as hauling of company material, including coal, maintenance and use of equipment, traffic and general expenses, are treated on a system basis.

2862 This method of allocating revenues and expenses partly on the basis of a foreign line and partly on the basis of system operation somewhat increases the income available for interest of the Milwaukee and Northern lines and correspondingly reduced the income available for interest for the General Mortgage Lines.

Conferences were made with the officers of the Debtor and as a result I have concluded after test calculations, that while some adjustments downwards would result from allocation on a strictly system basis, unless the General Mortgage Terminal Lines in Milwaukee were credited with substantially more than a switching charge for the traffic from and to the Milwaukee and Northern moving within the terminal, the income available for interest on the Milwaukee and Northern lines for the year 1936 would remain in excess of the interest on their Mortgage Bonds.

I think that is the situation. The question then came up as to the relative earning value of the Milwaukee and Northern First Mortgage Bonds. Subsequent to the hearing of September 20th, 1937, the Debtor made an estimated separation of the estimated revenues, expenses and the net

income of Milwaukee and Northern Lines for the year 1936, shown on Debtor's Exhibit No. 141, between the lines
2863 subject to the First Liens of the First Mortgage and the Consolidated Mortgage, i. e., South and North of Green Bay, Wisconsin, which has this day been filed or introduced as Exhibit No. 156, which shows $411,633 income available for interest of $95,265 on the Milwaukee and Northern First Mortgage Bonds, a coverage of 4.32 times.

Manifestly any adjustments downward by application of a formula on a strictly system basis would not, I believe, lower this coverage sufficiently to justify treatment other than 100 per cent of principal (interest being currently paid) in new first mortgage bonds and therefore this treatment is accorded to the Milwaukee and Northern First Mortgage Bonds in the Plan.

Q. Now, what about the Milwaukee and Northern Consolidated Mortgage Bonds?

A. The estimated separation of revenues and expenses and Net Income of Milwaukee Northern Lines referred to next above (Exhibit No. 156) shows for the year 1936 $83,549 income available for interest of $228,240 on the Milwaukee and Northern Consolidated Bonds, resulting in a deficit of $144,961 after interest.

While there is a spill-over of $316,368 of income available for interest on the lines upon which the Consolidated Mortgage has a second lien, after payment of the first lien
2864 interest, adjustments resulting from the application of a formula on a strictly System Basis totaling approximately $125,000 would give income available for interest or the Consolidated Mortgage Bonds, including the spill-over from the First Mortgage Lines, which would give the same coverage of Consolidated Mortgage interest as the coverage of the interest on the Chicago, Milwaukee and St. Paul Railway General Mortgage Bonds for the year 1936.

Therefore, the Milwaukee and Northern Consolidated Mortgage Bonds are accorded the same treatment as the Chicago, Milwaukee and St. Paul Railway General Mortgage Bonds, viz.: 60 per cent of principal and accrued and unpaid interest in New First Mortgage Bonds, 40 per cent in New General Mortgage Series A Bonds, and 1 share of no par common stock for each $1000 of claim.

I would just like to say here that the Milwaukee Terminals, which are a first lien of the General Mortgage Bonds or upon which the General Mortgage Bonds has a

first lien, are very extensive terminals, they reach a very large number of industries that are on the tracks of the Milwaukee Road, they give connection to the cross-lake car ferries of the Pere Marquette Railroad operating to Ludington, Michigan, and the Car Ferries of the Grand
2865 Trunk and Pennsylvania Railroads, operating across the Lake from Milwaukee to Ludington, Michigan, and in the allocation of earnings or revenues to the Milwaukee and Northern Lines the only credit that was given to the General Mortgage bonds, or putting it the other way, the only deduction that was taken from the full revenue of all traffic of that character as herein described was the switching charge between foreign railroads, the Milwaukee and Northern being treated as a foreign road in that respect.

Director Sweet: Is that a good place to stop?

Mr. Burgess: That is, Mr. Director, a very good stopping place. Would it suit the convenience of the Commission to start at 9:30 in the morning?

Director Sweet: Just a minute. You may be excused, Mr. Walker.

(Witness temporarily excused.)

Director Sweet: Major Oliver have you something to present before we adjourn?

Mr. Oliver: If the Director please, I have ready to present now, the petition for leave to intervene. I wish to file, if the Director please, on behalf of the Savings Banks of
2866 the States of Connecticut and Massahusetts who have so far authorized the group to speak for them, holding in the aggregate in excess of $8,000,000 of bonds of the Debtor. There are between twelve and thirteen millions of other bonds held by banks outside of those two States and it is understood that they will likely cooperate, and thus there will be a total of around $21,000,000.

Director Sweet: This is a group of Savings Banks, is it?

Mr. Oliver: Yes, sir.

Director Sweet: Who wish to intervene in this proceeding?

Mr. Oliver: Yes, sir.

Director Sweet: Have you served copies of the petition?

Mr. Oliver: Yes, sir, I have.

Director Sweet: Are there any objection to it?

(No response.)

Director Sweet: The petition is granted.

(Petition of Mutual Savings Bank Group Committee for leave to intervene was received.)

Director Sweet: There was another petition to be presented, has that been prepared?

Mr. McIntosh: No, Mr. Director, that has not been received from Chicago.

Director Sweet: Very well, the hearing will be in recess until 9:30 tomorrow morning.

(Whereupon, at 4:30 o'clock p. m. an adjournment was taken until 9:30 o'clock a. m. of the following day.)

2868 BEFORE THE

INTERSTATE COMMERCE COMMISSION.

Hearing Room C,
I. C. C. Building,
Washington, D. C.,
Wednesday, February 2, 1938.

Before:

Director Sweet, and Examiner Jameson.

The hearing was resumed, pursuant to adjournment at 9:30 o'clock a. m.

Appearances:

The same as heretofore noted.

Additional Appearances:

None.

2871 Proceedings.

Director Sweet: Mr. Walker, will you come forward please?

F. W. WALKER testified further as follows:

Direct Examination (Continued).

Mr. McIntosh: If the Commission please, on yesterday, I asked leave to file a petition to intervene in cooperation with Mr. Malcolm Mecartney, of Chicago. I have a telegram this morning in which he tells me that the petition is unavoidably delayed, and instructions are being sent in an air mail special delivery letter, which letter has not reached

my office, and I am therefore compelled to ask the further indulgence of the Commission.

Director Sweet: We will consider it when it arrives. Proceed, Mr. Burgess.

Mr. Burgess: We were about to discuss at the time of adjournment, the basis of the treatment of the General Mortgage Bonds, Mr. Walker. Will you proceed to treat with that subject?

The Witness: The income available for interest on the General Mortgage bonds for the year 1936 was determined as previously explained by deducting from the System Income Available for Interest, the estimated Income
2872 Available for Interest on the Chicago Terre Haute and South Eastern Railway Lines, on the Milwaukee and Northern Railroad Lines, on the Chicago, Milwaukee and Gary Railway Company Lines and on the Chicago, Milwaukee, St. Paul and Pacific Railway Company First and Refunding Mortgage Lines respectively, determined by the application of the formulae set out in detail in Debtor's Exhibits 140, 142, 144 and 146.

Certain items in each formula are treated on a foreign road basis and certain other items on system operation basis. In none of the formulae do the General Mortgage lines receive any compensation for its investment in shops, roundhouses, etc., used in connection with repairs and servicing of equipment.

Rental of company owned equipment is apportioned in such a manner that the General Mortgage is required to bear the carrying charges on reserve equipment necessary to meet requirements during periods of traffic.

Nevertheless, in the year of 1936 the income available for interest on the General Mortgage Bonds, after providing for interest on equipment trusts in the amount of $1,155,159, was $7,561,688 giving a covering of 1.16 times interest on the General Mortgage Bonds including $11,212,000
2873 Series G 5 per cent General Mortgage Bonds pledged with the Reconstruction Finance Corporation.

This is shown on Exhibit No. 181, which was introduced in the hearing yesterday. Exhibit No. 181 shows in the first column the system earnings for 1936; in the second column the estimated earnings of the Chicago, Terre Haute and Southeastern, as shown in Exhibit No. 139, and as estimated on the basis of the formula, No. 140.

The third column shows the Milwaukee and Northern

estimated earnings, shown on Exhibit No. 141, and estimated in accordance with the formula, in Exhibit No. 142.

The Chicago, Milwaukee and Gary, Exhibit No. 143, and the formula Exhibit No. 144, shown in the fourth column.

The next three columns show the estimated earnings of the First and Refunding Mortgage Line, as shown on Exhibits Numbers 141 and Formula No. 146, separated between lines west, pieces of lines east, and then totaled.

The next to the last column is the total also of the estimated earnings of the Terre Haute, Milwaukee and Northern, Chicago, Milwaukee and Gary, and the First and
2874 Refunding Lines, or, rather, the estimated income account, and the last column the balance remaining for the General Mortgage, which shows, as I have stated, that the income available for interest is $7,561,000, after deducting interest on Equipment Trusts.

Now, in connection with the statement that I have made that the General Mortgage is not compensated in these formulae for the carrying of excess equipment and motive power required during the peak periods, the rental of equipment is based, among other things, upon 5 per cent interest upon the depreciated value of the equipment, and the amount of equipment and motive power upon which the interest is charged is determined by monthly averages of use.

Manifestly, a monthly average on a use basis leaves with the owner of the equipment the carrying of the excess equipment and motive power to provide for peak load business.

That is, it does in my opinion.

It is confidently believed that the application of formulae on a strictly system basis with proper provision for use of property under one mortgage for the benefit of other mort-
gages, would result in a somewhat larger amount of
2875 net income for the General Mortgage Lines and correspondingly less income for the other mortgage lines.

And in connection with that I would like to say that investment in shops, roundhouses and other facilities that are under one mortgage, when used in connection with equipment, making of repairs, and other services for other mortgage lines, should, it seems to me, entitle the owning line to some compensation for use, which should be included as an increment of the cost of repairs or service rendered.

Q. What is the general character of the General Mortgage Lines, Mr. Walker?

A. The general character of the General Mortgage Lines is that they constitute a well integrated system, that prior to the construction of the First and Refunding Lines the General Mortgage Lines were operated profitably for many years. These lines are in my opinion the heart and backbone of the present system upon which the other mortgage lines are dependent for the major portion of their revenue.

Taking into consideration the estimated earnings of the several mortgage lines determined by the Debtor under the formulae as outlined and other factors considered relevant,
it is believed that the Milwaukee and Northern Con-
2876 solidated Mortgage Bonds—which I discussed yester-
day as to the relative earnings, and estimated income of the Milwaukee and Northern Lines, separated between the lines South of Green Bay and the lines north of Green Bay—and the General Mortgage Bonds are entitled to substantially equal treatment and to priority in the satisfaction of their claims over the claims of the Chicago, Milwaukee, St. Paul and Pacific Railroad Company, Fifty Year, 5 Per Cent Mortgage Bonds, over the claims of The Chicago, Milwaukee and Gary Railway Company First Mortgage Fifty Year 5 Per Cent Bonds and over the claims of the Chicago, Milwaukee, St. Paul and Pacific Railroad Company Convertible Adjustment Mortgage Bonds of 5 per cent due January 1, 2000.

Accordingly, holders of claims with respect to Chicago, Milwaukee and St. Paul Railway Company General Mortgage Bonds 3½ per cent, 4 per cent, 4½ per cent and 4¾ per cent, due May 1, 1989, aggregating $153,392,066, will be allotted securities of the Reorganized Company as follows:—

And I might say that the claims include principal of bonds and interest at coupon rates to June 30, 1938. There will be accorded the following treatment:

$92,035,000 in principal amount of First Mortgage Bonds,
Series A, $61,357,000 in principal amount of General
2877 Mortgage Income Bonds, Series A, and 153,392 shares
of Common Stock, so that the holders of each $1000 of such claim will receive 60 per cent thereof or $600 in First Mortgage Bonds, Series A, 40 per cent thereof or $400 in General Mortgage Bonds, Series A, and one share of Common Stock; for each $1,000 of claim in considering this treatment, the varying coupon rates upon the General Mortgage Bonds were treated in this manner:

That up to the date of the reorganization, the coupon interest rates prevailed, and the unpaid and accrued interest at that rate is added to the principal. Thereupon that becomes the total claim of each of those bondholders, that is, of the bondholders holding each Series of General Mortgage Bonds. Their claim is then part principal of the bonds and part interest, which runs to that date, and in reorganization, if the claim which exists at the time is satisfied on an equal basis, that is, claims of the same class are treated in the same manner, that is, in my opinion, fair and equitable treatment, and the basis upon which this allocation of securities was made to the General Mortgage Bondholders.

Q. What is the basis of the allotment of one share of common stock?

2878 A. The General Mortgage Bondholders at the present time have a first lien upon the heart of the Milwaukee System, as stated, and in the Reorganization Plan submitted by the Committee, the General Mortgage Bonds receive 60 per cent of new First Mortgage Bonds, and in the Plan there is planned ahead of income to be received by General Mortgage Bondholders on the securities junior to the new first mortgage bonds which will be given and is given to the junior mortgage bonds in satisfaction of the remainder of their claim, a compulsory improvement and betterment fund, of a minimum amount of two and a half million dollars.

In addition to that, the General Mortgage Bondholders in satisfaction of their present first mortgage position receive 40 per cent in second mortgage income bonds, upon which the interest is contingent upon earnings, and interest is cumulative only to the extent of a maximum amount of three years' interest, namely, 13½ per cent.

Therefore, the General Mortgage Bondholders, in satisfaction, partial satisfaction, or in satisfaction to as large an extent as it seemed would be practicable under these conditions, although manifestly not, in my opinion, in full satisfaction of the sacrifices for change in their posi-
2879 tion, the General Mortgage Bondholders were awarded or alloted one share of common stock for each $1,000 par value of bonds.

Examiner Jameson: Are you going to explain the ratios of 60 and 40 per cent, and how they were arrived at?

The Witness: The 60 per cent and 40 per cent were arrived at in this manner:

If we turn to Exhibit C, page 55, of the plan, as testified to, and as shown in the plan, the minimum earnings for the period, or rather the minimum average earnings that could reasonably be expected in the future year, taken as the average for 1931-1935 period, those averages, amounted to $7,859,000. With a coverage of 1.2 per cent of the fixed charges, this limited and set the limit for the total amount of the fixed interest bearing obligations that should be outstanding at reorganization under the Plan.

Q. (By Mr. Burgess.) That is, supposing the coverage were 120 per cent?

A. 1.2 times coverage. The coverage was 1.2 times the interest charge.

In order to have that coverage, the amount of fixed interest bearing obligations at the time the Plan would be consummated, which is assumed to be June 30th, 1938, was limited to $162,931,000, as shown on Exhibit A, page
2880 49, consisting of equipment obligations of $30,516,671, undisturbed by the plan; loans, total claimed $13,647,609; the R. F. C. Loan and Collateral Trust Notes, being satisfied 100 per cent in new First Mortgage Bonds; the Railroad Credit Corporation Loan it is assumed will be fully discharged by the date of bankruptcy, or else the small balance remaining will be paid.

Therefore, that disappears from the picture.

Yesterday when asked the question as to whether or not the Reconstruction Finance Corporation Loan and Collateral Trust Loans were satisfied, I understood the question to be as to whether or not the plan fully satisfied those loans, and not as to whether the Reconstruction Finance Corporation was satisfied with the treatment.

If the question was as to whether the Reconstruction Finance Corporation were satisfied with the treatment and felt that the treatment was fair and reasonable, I might add that I have discussed the matter with the Reconstruction Finance Corporation, and I would prefer that the Reconstruction Finance Corporation make their own statement on the record as to their position with respect to their treatment.

This leaves fixed interest-bearing obligations after
2881 treatment of the equipment obligations and the loans for leased company mortgages, and leased company mortgages, namely the mortgage debt of the Chicago, Terre Haute and South Eastern Railway is satisfied in the plan as to their claim 100 per cent in new First Mortgage Bonds.

The Milwaukee Northern First Mortgage is satisfied as to its claim 100 per cent.

There then remains out of the total fixed interest bearing obligations of the new company which will amount to $162,931,000 par value, $95,158,000 par value of new first mortgage bonds to be distributed under the plan between the General Mortgage Bonds and the Chicago, Milwaukee and St. Paul Railway and the Milwaukee and Northern Consolidated Mortgage Bonds, which are given equal treatment.

That is what limits and fixes the 60 per cent treatment given to the bonds under those two mortgages. Then again the limitation as to the treatment of 40 per cent of the Series A General Mortgage Income Bonds, which under the Plan are allotted to the Chicago, Milwaukee, St. Paul and Pacific general mortgage bonds, and the Milwaukee and Northern Railway Consolidated Mortgage Bonds, that limit again was fixed by the relative proportion of
2882 debt to stock in the capital structure, which was considered sound, and also by the covera that it was believed the Series A General Mortgage Bonds should have, in order to compensate the old General Mortgage Bondholders for the surrender of their first mortgage position and fixed interest obligations.

The various coverages are shown and explained in the Plan itself, and are also shown in Exhibit C, page 55 of the Plan Times fixed interest earned on the obligations of the reorganized company are 2.42 times in the future average normal year.

Examiner Jameson: How about the Terre Haute Bondholders who now receive 5 per cent and who will get 4 per cent under your Plan?

The Witness: The Terre Haute Bondholders now receive 5 Per Cent for Mortgage obligations upon a railroad which is operated under lease, the lease being in default with respect to equipment replacements to the extent of $7,500,000 or thereabouts. The road is a coal road and is dependent primarily for the major part of its earnings upon the continuation of the purchase of fuel by the Milwaukee Road, and I would say additional commercial fuel, the traffic that comes to the Terre Haute by reason of such purchase. They are given in exchange First Mort-
2883 gage Bonds which are a First Mortgage lien upon the entire system of the Milwaukee Road and the present line of the Terre Haute.

There are also defaults under several of those mortgages, by reason of the failure to meet the Equipment Replacement requirements.

The Lease, as I have stated, does not permit of abandonments, and, therefore, the present bondholders of the Terre Haute Line, who, if the Terre Haute Line is divorced from the Milwaukee Road, or if not divorced have the hazard at maturity of being unable to collect the principal of the bonds, because not only is there a hazard at maturity to the bondholders of the Terre Haute for the collection of the principal of their bonds, but there is also a hazard to the Milwaukee Road if the Lease is continued, as to its ability to refund or pay under its guarantee, to pay the principal of the Terre Haute Bonds under its guaranty.

Therefore, it is felt that under all the circumstances and conditions, with the Terre Haute Lines consolidated with the Milwaukee System, which it is believed to be a fair and sound solution of the present situation, that the Terre Haute Bondholders will receive in exchange for the present holdings bonds which have a value at reorganization
2884 equal to the value of the bonds that are being surrendered or exchanged, and that the assurance of continuity of income and of reimbursement of principal that flows to the Terre Haute Bondholders from these new System Bonds will compensate, and does compensate, for any change in coupon rate that there is, as shown in the Plan, between the Terre Haute Bonds and the new System Bonds which the Terre Haute Bonds will receive.

Examiner Jameson: There is one class of bonds there which will receive 4 per cent now, as I understand it.

The Witness: Yes, sir.

Examiner Jameson: The Southern Indiana.

The Witness: Yes, sir. Those bonds are underlying bonds and, as we look at those bonds, they are underlying bonds and receiving as underlying bonds the same coupon, that is true, as do their bonds at the present time. But it seems to me that the measure of whether or not the treatment is fair and equitable is whether the securities which they receive at reorganization, with the coupon rate as provided for the particular security received, represents at that time reimbursement of their claim, and whether or not that really represents bonds that within a reasonably short time after reorganization, so that the bonds of
2885 the reorganized company will no longer be depressed in the market from the fact that the company has just

emerged from bankruptcy; that these first mortgage bonds of the reorganized company, with the low fixed charge, are worth their face, or will be worth their face, within a reasonably short time after reorganization, and that a 4 per cent coupon represents a fair interest return upon the principal of the bonds.

Q. (By Mr. Burgess.) Now, can we turn to the matter of the Fifty-year 5 per cent Mortgage Bonds due in 1975, the so-called 5's of 1975, and will you discuss the basis of the treatment of those?

A. The Chicago, Milwaukee, St. Paul and Pacific Railroad Company Fifty Year Mortgage has no first lien on any property but is secured primarily by a second lien on the property subject to the first lien of the First and Refunding Mortgage.

The First and Refunding Mortgage is secured primarily by a first lien on the lines west of Mobridge at the Missouri River and pieces of line east of Mobridge.

The relative value of the Fifty-year 5 Per Cent Mortgage Bonds comes from the earnings, if any, remaining after satisfaction of First and Refunding Mortgage, under which $8,923,000 par value of bonds have been issued 2886 and pledged.

The Debtor's estimate of Income Available for Interest on the First and Refunding Mortgage lines for the year 1936, is found to be a Deficit of $938,435, before interest and dividends in the amount of $420,031 received during the year 1936 on Securities pledged under the First and Refunding Mortgage.

That is Exhibit No. 145 and Exhibit No. 181, the latter being introduced in the record yesterday, shows the estimated earnings of the First and Refunding Mortgage.

Q. I think that figure, Mr. Walker, of $420,031 which you used there is properly $402,031.

A. $402,031, which is the income that has been received upon the collateral.

As previously shown under treatment accorded in Reconstruction Finance Corporation Loan and Collateral Notes, substantially all of the $402,031 income from collateral is absorbed, leaving only the deficit of $938,435 in 1936 available for interest on the First and Refunding Mortgage Lines as security for the second lien of the Fifty Year Mortgage Bonds.

I might review, or rather—

Mr. Pantaleoni: May I ask if there is an Exhibit showing the $938,000 figure? I cannot find it.

2887 The Witness: If you will take Exhibit No. 181, you will find $402,031.

Mr. Pantaleoni: I have that.

The Witness: There is a little memorandum there, "Interest and Dividends on Pledged Securities", and if you add that figure to the deficit of $536,404—

Mr. Pantaleoni: Where is that?— Oh, I have got it.

The Witness: We then get the deficit without the income on pledged securities of $938,435.

Mr. Pantaleoni: I see.

The Witness: Now, in connection with this income from securities, we have the Reconstruction Finance Corporation loans and the collateral pledged thereunder is shown in Exhibit No. 172, and included in this collateral are substantially all of the outstanding first and refunding bonds which are pledged under the Reconstruction Finance Corporation Loans and under the Collateral Notes.

The remainder of the First and Refunding Bond issue is pledged as additional security for an Equipment Trust issue which the Reconstruction Finance Corporation holds.

2888 Mr. Sykes: Is that on page 9 of the Plan, for example, and other places in the mortgages which appear in the Plan, where there is mention made of the First and Refunding Mortgage? Rather, this is included in collateral which appears in other obligations of the company?

The Witness: Yes, sir, the bonds under the First and Refunding Mortgage that are outstanding, or have been issued, are pledged and it is provided in the Plan that the collateral, that is the First and Refunding Bonds and other System collateral pledged upon the satisfaction of loans and notes, will be cancelled and the other collateral, non-system collateral will be pledged under the first mortgage and with a second lien under the new General Mortgage.

Mr. Sykes: That is why the First and Refunding does not appear in the list of Mortgages?

The Witness: That is the reason why it does not appear in the Plan, because the bonds are cancelled and the mortgage also will be cancelled.

The collateral pledged under the Reconstruction Finance Corporation loans which produced the income of $402,031

during the year 1936 was capitalized at 5 per cent, giving a value of $8,040,620.

The income of the First and Refunding Mortgage
2889 Lines available for interest for the year 1936, without including the $402,031 income received on this collateral was, as previously stated, a deficit of $938,435.

Therefore, the value of these lines to the balance of the system is, for all practical purposes, offset by this deficit and value of the First and Refunding bonds as collateral, is limited to $8,040,620 and on the basis upon which the collateral value of the bonds was estimated, which I believe to be a reasonable estimate of their value.

And in connection with that I might say that the trustee under the First and Refunding Mortgage has in its possession the cash that has been received during the bankruptcy as income upon this collateral, the total amount of which at the present time, according to Exhibit No. 173, held by the Trustee of the First and Refunding Mortgage amounts to $789,133.41.

Now, it might be held by some that this cash that is held by the Trustee of the First and Refunding Mortgage represents a value now, in the way of cash, that should be turned over to the First and Refunding Bondholders, or the Pledgees of those bonds, but from information furnished by the Debtor, which was available to any creditors
2890 asking for such information, it develops that during the period of bankruptcy, expenditures for additions and betterments amounted to $12,490,000 on road and on equipment $1,867,000, new equipment not acquired under trusts, $14,589,000, and with those capital expenditures $11,108,000 was expended upon the General Mortgage Lines.

Now, there was a balance remaining of $3,481,000 expended on other lines.

The amount of work involved in obtaining the actual amount of those expenditures upon the First and Refunding Lines appeared to be unwarranted and prohibitive, but an approximation was made which shows that in excess of $2,000,000 of improvements and betterments were expended out of the funds of the Trust Estate, which should be represented by other mortgage lines in improvements and betterments on the first and refunding line.

So that there again we have this situation of the first and refunding lines operating with an estimated deficit in 1936 of $938,000 and 1936, the income accounts of the Debtor show, was a more profitable year than the other years dur-

ing the real depth of the depression, or since the depth of the depression.

2891 We have in addition to this $938,000 estimated operating deficit, the necessity to expend during that period on that line in excess of $2,000,000 for additions and betterments which naturally would not come out of the income or estimated income of the First and Refunding Lines.

Q. (By Mr. Burgess.) In order that the record may be correct, Mr. Walker, my attention is called to the fact that Exhibit No. 173 is an Exhibit showing the cash held by the trustee of the first and refunding mortgage and not Exhibit No. 171. I do not know whether your marking is the same as mine or not.

A. No. 173 is the exhibit that shows the cash held by the trustee of the first and refunding mortgage.

Q. Now, is there anything further which you think it desirable to say about this subject of the treatment of the 5's of 1975?

A. Consideration was given to the question of business contributed to the balance of the system, as shown on Debtor's Exhibit No. 145, and applying a system freight operating ratio of 69.81 for the year 1936 would leave $1,886,603 as the net contribution to the lines East of Mobridge, which are primarily general mortgage lines, but which nevertheless include the Milwaukee and North-

2892 ern Lines and also the pieces of the lines under the first and refunding mortgage.

Now, if this net contribution is equally divided between the First and Refunding Mortgage Lines and the General Mortgage Lines—and naturally it would be inequitable to expect the General Mortgage Lines to carry this traffic merely at cost—then it also appears that the General Mortgage Lines would not lose the entire traffic that passes over the First and Refunding Lines, if its lines were separated from the system.

On that basis of considering those matters, the first and refunding lines were credited with one-half of the contribution to the remainder of the system of $1,886,603 in reaching a conclusion as to what is the real value in reorganization of these first and refunding lines to be used as a basis for the distribution of securities.

This allocation of half of the contribution substantially equals the operating deficit in 1936, as estimated by the

Debtor, the operating deficit being $938,000, and the one-half which is credited being $943,000.

It just happens to come out that way from the data and figures and calculations made in the estimates in determining the amount of business contributed to the balance
2893 of the system.

Now, there is a further consideration also, it seems to me, in connection with the value of these first and refunding lines, and that is that the territory served by the first and refunding lines is highly competitive and for long stretches is of such a character that little traffic is produced. The competition is confined not only to other steam railroads, but also as to the long haul it includes the coastwise shipping via the Panama Canal.

Taking into consideration the conditions and circumstances affecting the first and refunding lines I reach the conclusion that full recognition would be given to the value of the First and Refunding Lines to the system by alloting to the holders of the claims with respect to the Chicago, Milwaukee, St. Paul and Pacific Railroad Company, 50 year 5 per cent Mortgage Bonds due February 1, 1875, aggregating $124,570,925 securities of the Reorganized Company as follows:

General Mortgage Convertible Income Bonds, Series B, in the principal amount of $49,828,000 equally secured as to principal with the General Mortgage Income Bonds Series A allotted to the Milwaukee and Northern Con-
2894 solidated Bonds and the General Mortgage Bonds, but junior to the Series A Bonds with respect to the obligation to pay interest, and also awarding Preferred Stock of the par value of $100 per share in the par amount of $74,743,000 and 124,571 shares of Common Stock, so that the holders of each $1000 of such claim will receive 40 per cent thereof or $400 in General Mortgage Convertible Income Bonds, Series B, 60 per cent thereof or $600 in Preferred Stock and one share of Common Stock.

Now, under all circumstances this may appeal to some as being a more generous treatment than the 5's of 1975 are entitled to receive. The first and refunding bonds go out of the picture, and here the 5's of 1975 are given a mortgage position, second mortgage position as to 40 per cent of their claim, which includes accrued interest, standing on a footing, an equal footing with all the General Mortgage Bonds, that is, the old general mortgage bonds receive for 40 per cent of their claim.

I am frank to admit that in my own mind I feel that there may be some question as to whether, as to lien on this system, the first and refunding bonds should have any parity in lien as to principal. However, I recognize the
fact that the value of the first and refunding lines to
2895 the system is a matter that it is difficult to determine accurately, or with accuracy, under all the conditions existing, and under those circumstances it seems to me that the first and refunding bonds should be given the benefit of the doubt in my own mind as to the value of that specific extension to the system, and be given some securities that as to principal stand on a parity with some of the securities that were given to the first mortgage bonds or old general mortgage bonds, which were first mortgage bonds, in the satisfaction of their claim.

The amount of 40 per cent was limited by the amount of new General Mortgage Income Bonds, that could be distributed in order to keep the coverage within limits and that is, interest coverage within limits that would be met by the income available for interest under the plan in the future average normal year.

Giving to the 5's of 1975 a mortgage position in proportion to their claim, a mortgage position as to principal on a parity with the mortgage position of the old general mortgage bonds for a portion of their claim, the payment of interest of Series A new general mortgage income bonds
given to the old general mortgage bonds and old Mil-
2896 waukee and Northern Consolidated Mortgage Bonds was made or given priority of payment over the income or interest on Series B new general mortgage income bonds, allotted to the 5's of 1975, after further consideration of this problem, which I recognize as being really one of the major problems in connection with the plan of reorganization and the allotment of new securities in satisfaction of the present claims and further adding to the value of the new securities given to the 5's of 1975, the coupon interest rate was increased to 5 per cent in the modified plan, from the original proposal in the plan, filed January 10th of 4½ per cent.

The 5 per cent is covered in the future average normal year, as forecast, and upon which the plan is based.

So that the 5's of 1975 receive 40 per cent in new General Mortgage Series B Income Bonds, with a 5 per cent coupon, having a second lien upon the entire system and property of the reorganized company, junior only to the

Series A Bonds awarded to the old general mortgage bondholders, the Series A Bonds bearing a 4½ per cent interest coupon, junior only as to the payment of interest on the Series B Bonds, which is obligatory, if earned, and, in addition, as compensation for the limited accumula-
2897 tion of interest which is provided for, namely, three years maximum at any time or full interest which for Series B amounts to 15 per cent accumulation as against 13½ per cent for Series A, the 5's of 1975, for this failure or sacrifice for the limited accumulation provision and for the preferred stock being non-cumulative, are given one share of common stock for each $1,000 of their claim, which is the same amount of common stock that is given to the Milwaukee and Northern Consolidated Bonds and the old general mortgage bonds in compensation for similar sacrifices which the plan imposes upon them.

Q. (By Mr. Burgess.) Now, will you discuss the treatment accorded the Chicago, Milwaukee and Gary 5 Per Cent Forty-year Bonds?

A. The Debtor's estimated Revenues, Expenses, and Income of the Gary Line, as shown on Debtor's Exhibit 143, under formulae shown in Debtor's Exhibit 144 clearly show that an intensive study should be made looking toward abandonment of substantial portions of the line in the interest of economy. In any event, it is quite clear that its lack of earning power and of importance as a part of the system resulting from the burdensome provisions of the contract for trackage rights over the Elgin,
2898 Joliet and Eastern Railway Company (record page 115) leads to the conclusion that the holders of claims with respect to Chicago, Milwaukee and Gary Railway Company First Mortgage 5 Per Cent, 40 Year Bonds due April 1, 1948, aggregating $3,487,500 are not entitled to receive secured obligations of the Reorganized Company for any portion of their claims and therefore in full satisfaction of their claims, the holders of claims with respect to Chicago, Milwaukee and Gary Railway Company First Mortgage 5 Per Cent, 40 Year Bonds, due April 1, 1948, aggregating $3,487,500, will be allotted securities of the Reorganized Company as follows:

$3,487,500 in par amount of $100 par value Preferred Stock, so that the holders of each $1000 of such claim will receive 100 per cent thereof or $1000 in Preferred Stock.

Q. What about the treatment accorded to the Adjustment Bonds?

A. I would like to call attention, before leaving the Milwaukee and Gary, to the fact that the trackage rights referred to over the Elgin, Joliet and Eastern Railway are right in the center of the Gary Line, that is, really in effect cuts that line in two, and the provisions of that track-
2899. age agreement are shown on page 115, which takes away from the value of the Gary Line, or the possibility of its future development very, very materially.

The Chicago, Milwaukee, St. Paul and Pacific Railroad Company Convertible Adjustment 5 Per Cent Bonds are secured by a third, a fourth and a fifth lien on the property of the Debtor.

The securities allotted to these bonds should therefore be junior to the securities allotted to liens senior thereto.

The claims with respect to these bonds recognized in the Plan amount to $257,851,906—that is shown on Exhibit A, page 49—consisting of $182,873,693 of principal, $47,547,-160 unpaid accumulated interest to June 30, 1935 (date of bankruptcy) and $27,431,053 accrued and unpaid interest thereafter to the date of consummation of the Plan assumed as June 30, 1938, and therefore in full satisfaction of these claims, the holders of claims with respect to Chicago, Milwaukee, St. Paul and Pacific Railroad Company Convertible Adjustment Mortgage Bonds 5 Per Cent due January 1, 2000, aggregating $257,851,906, will be allotted securities of the Reorganized Company as follows: 2,578,-
519 shares of Common Stock without par value so that
2900 the holders of each $1000 of such claim will receive 10 shares of Common Stock.

Q. What about the treatment accorded general creditors?

A. I might add, I think at this point, that the preferred stock which has been awarded in part in the settlement of the claim of the 5's of 1975 and in settlement, full settlement of the claim of the Chicago, Milwaukee and Gary First Mortgage 5's of 1948, is not cumulative, but it is participating with the common stock, and it participates with the common stock equally per share, up to one dollar per share after the common stock receives a dividend of $3.50 a share.

The basis upon which the $3.50 a share dividend on the common stock was determined was this:

That when the common stock which has been allotted to the Adjustment 5's in full settlement of their claims receive a dividend of 3½ per cent, the holders of the present

adjustment 5's will receive the same amount of interest, namely, 5 per cent upon the principal of the Adjustment Bonds now outstanding, and thereafter it was felt—and I believe that was sound—that before the Adjustment Bondholders receive any additional income there should be additional income flowing to the present holders of the 5's of
1975, and the Milwaukee and Gary, to compensate
2901 them for the preferred stock being non-cumulative.

It is also concluded—and I believe that conclusion is sound—that there should be a definite limitation of this participation by the preferred stock, and that a one dollar limitation bringing the dividend rate up to 6 per cent was reasonable, in view of the fact that the plan also provides that no dividends shall be paid upon the common stock until dividends have been paid in full on the preferred stock for three consecutive years.

So that with this provision with relation to the preferred stock, it was felt that a one dollar additional participation was fair to the holders of the 5's of 1975 with respect to the preferred stock which they receive, was fair to the holders of the Milwaukee and Gary Bonds with respect to the preferred stock which they receive, and was not unfair to the holders of the Adjustment 5's with relation to the common stock which they receive in settlement of their claims.

With regard to the General Creditors, all unsecured claims not entitled to preference, when the claim has been duly allowed by the Special Master, will be allotted one
share of the Common Stock without par value of the
2902 Reorganized Company for each $500 duly allowed.

All other valid liabilities and obligations of the Debtor, if any, for which no specific provision is made in the Plan shall be allotted one share of the new Common Stock of the Reorganized Company for each $500 of such liabilities and obligations.

Q. Do you want to say anything further about the matter of general creditors, before proceeding with the treatment of the present preferred and common stockholders?

A. I do not thing that I have anything further to say there, except, that the general creditors, as shown in Exhibit A, estimated as of September 30th, have claims aggregating about $445,162.

Director Sweet: Have any of the general creditors been compensated by your proposal?

The Witness: No, sir.

Director Sweet: Are they represented here, so far as you know?

The Witness: Not that I know of, no, sir.

Q. (By Mr. Burgess.) Mr. Walker, our plan does not provide for participation by the present preferred and common stockholders of the bankrupt company, does it?

A. It does not.

2903 Q. Why is that?

A. Committee's Exhibit No. 182 shows for the fourteen year period 1921 to 1934 the income available for interest as reported and as available for interest modified as follows:

"Reported Income Available for Interest for Years 1921-1934, modified by adding back. For the Years 1921-1934, the rental under the Chicago, Terre Haute and South Eastern Railway Company lease (excluding interest on Chicago, Terre Haute and South Eastern Railway Company First and Refunding Bonds owned) adding back equipment retirement charges and amortization of debt discount; for the Years 1928-1934, adjustment of depreciation accruals (as estimated by Debtor for Years 1928-1929; and as made by I. C. C. Bureau of Accounts for Years 1930-1934); for the Year 1934, restoring charges under Railroad Retirement Act not actually incurred; and for Years 1927-1932, adjustment of State of Washington taxes. Committee's Exhibit No. 183 shows the detail of these adjustments for the years 1921-1929; and Committee's Plan, page 57, Exhibit D, shows the adjustments for years 1930 to 1934.

With respect to these adjustments, the basis for the adjustments is the report, Exhibit No. 185, which will be supported by testimony of another witness.

2904 Committee's Exhibit No. 182 also shows the Committee's prediction for the future for a normal year and the annual interest requirements of the present funded debt. It will be seen from this Exhibit No. 182 that the average income available for interest as modified for the period 1921-1934 was $17,409,017 which falls short of the total annual interest on principal only of present funded debt amounting to $23,705,163 by over $6,000,000 and falls short of the total annual interest on principal of and accrued and unpaid interest on the present funded debt amounting to $28,967,023 by more than $11,500,000. The lack of coverage of the total annual interest on principal only of present funded debt and on principal of and ac-

crued and unpaid interest on the present funded debt was much greater in the periods 1930-1934; 1931-1935; 1932-1936; 1931-1936; 1933-1936, (Exhibit D, page 57 of the Plan) than for the 1921-1934 period.

I would like to call attention to the fact the adjustments which have been made as shown on Exhibit 182, in considering whether past earnings—

Mr. Sykes: You mean Exhibit 182?

The Witness: Yes, sir.

Mr. Sykes: What page?

The Witness: I mean Exhibit 182.

Mr. Sykes: You said page 182.

2905 The Witness: I mean Exhibit 182.

The adjustment shown and taken into consideration in arriving at the modified income available for interest shown on Exhibit 182 results in a higher or larger amount of income available for interest than reported by the Debtor, and in considering the question of whether or not the system earned its present fixed or present interest charges during this period of 1921-1934, it was felt necessary to add back into the income account the adjustment shown on Exhibit 183.

Q. (By Mr. Burgess.) What have you to say about present earnings in respect to this treatment of the stockholders of the bankrupt company?

A. The income available for interest for the year 1936 as modified was $12,298,916 (Exhibit D, page 57 of the Plan) and as reported for the year 1937 was $1,026,597 less than as reported for the year 1936, including a credit in 1937 of $1,523,755 reversing charges in 1936 account Railroad Retirement Act amended, effective January 1, 1937. The present earnings represented either by the year 1936 or 1937 show that income available for interest in 1936 was only about one-half and in 1937 less than one-half the annual interest on principal only of present funded debt amounting to $23,705,163. (Committee's Exhibit 182), introduced into the record at this hearing.

2906 Q. What about the test of prospective earnings?

A. The estimated earnings for the future average normal year as shown on pages 10 and 12 of the Plan are the following:

	Total Operating Revenues	Income Available Interest
Committee Estimate for Future Average Normal Year	$126,900,000	$15,894,000

The estimated income available for interest in the future average normal year of $15,894,000 falls short of the total annual interest on principal only of present funded debt by $7,811,000 and falls short of the total annual interest on the total present debt by $13,073,000. These shortages are after interest only without provision for charges for additions and betterments and sinking fund payments. If an Additions and Betterments Fund which I believe to be essential and sinking funds are taken into account, the shortages would be increased by around $3,000,000. That there has been a substantial loss in traffic, some of which represents a permanent loss with consequent reduction in gross revenues, is generally conceded and with so wide a difference between the estimated income available for interest in the future average normal year and interest requirements on principal only of present debt, namely, $7,811,000, and on principal and accrued and unpaid interest on the total present debt by $13,073,000, the hope of meeting these present interest requirements from earnings is in my opinion too remote to be seriously entertained.

In addition to that there is $63,000,000 of additions and betterments payments and sinking fund provided in the plan.

After analysis of the position of the present stockholders in the light of the facts disclosed that the average income available for interest during the 14 year period 1921-1934, that income available for interest at present either in 1936 or in 1937 and that the prospective income available for the future average normal year are all insufficient to meet interest charges on the present debt by such wide margins, exclusive of requirements for additions and betterments, the conclusion, in my opinion, is inescapable that the equity of the stockholders has no present nor prospective value.

Q. The next exhibit I will ask you to treat is the matter of capitalization of earnings. Did you take into ac-

count capitalization of earnings in arriving at some of your conclusions?

A. I did. Section 77 of the Bankruptcy Act lays particular stress upon earnings as the measure of value
2908 for capitalization of a reorganized company. I believe that the record conclusively shows that past, present and prospective earnings are insufficient to justify the participation in the plan of the present preferred and common stockholders of the Debtor. The results obtained by capitalizing present and prospective earnings also supports this conclusion. While capitalization of earnings may not be the sole test of the limits of the capital structure, it is a factor which corroborates the showing already made that the present preferred and common stock has no value.

The rate at which earnings of corporations may be capitalized varies, in my opinion, with the type of corporation being considered and the purposes for which capitalization is made. The earnings of corporations engaged in a highly competitive business, being subject to wide fluctuations, should, I believe, be capitalized at a comparatively high rate.

I believe that a rate of 5 per cent for the capitalization of earnings of this bankrupt property is a low and conservative rate. In this connection it should be noted that the average rate of interest paid by the Debtor on its funded debt is 4.70 per cent.

Director Sweet: Did you capitalize the earnings at all in getting at the total capitalization in your proposal
2909 or under the plan?

The Witness: Yes, sir. I used the capitalization of earnings in this manner. After capitalizing the earnings at 5 per cent and capitalizing earnings at 4.7 per cent, it was evident that the capitalization based solely upon earnings would not support a capital structure in which all of the securities had a fixed and definite par value. In connection with that, as well as in connection with whether present stock has any value, the use of no par stock gives a margin to take care of what may be proven to be the insufficiency of forecasted revenues. With the margins as wide as they are shown to be here with respect to the earnings and the present charges in so far as the value of the stock is concerned, in my opinion, it has no prospective value in so far as capitalization is concerned. It is hoped, as stated in the Plan,—that with an increase in business

generally and with greater prosperity in the future, the no par common stock, which is awarded primarily to the adjustment 5s of 2000 will have value. The value of that stock, however, is dependent upon greater earnings in the future than are shown in the forecast which the Committee has made as the basis for income available in the future average normal year.

Director Sweet: It is dependent also on earnings 2910 greater than the average for the years 1921-1934?

A. Yes, sir.

Q. As a matter of fact, if you assumed that the par stock, if you have assumed that for the purpose of certain comparisons, is to be given a stated value of $100 a share, how much would your earnings have to be to warrant a capitalization of 5 per cent on an amount of $640,000,000—odd?

A. There would on that basis have to be $32,000,000 available for interest.

Q. The average for the fourteen year period you have shown on Exhibit 182 after you have modified that is $17,409,000?

A. The average, yes, sir. That is the average. The largest was $32,885,000.

Q. That was in 1928?

A. In 1928.

Q. The average is $17,409,000?

A. Yes, sir.

Q. (By Examiner Jameson.) Mr. Walker, can you state the total capital assets of the System, the book assets, and the total of the preferred stock? My question would be what you would consider the total capitalizable assets. Perhaps you cannot answer at this time.

A. I am frank to say I cannot answer at this time.

2911 Q. Have you given any consideration to that at all in connection with the equities in the preferred stock?

A. I have given consideration to the valuation of the property as shown by the report of the Bureau of Valuation, the various elements of value. I have given consideration to past and present and prospective earnings and, giving consideration to the elements of value in the light of past, present and prospective earnings, I cannot help but reach the conclusion that the preferred stock and common stock has no value.

Q. (By Mr. Burgess.) The entire capitalizable assets

seems to have crept into these hearings in some way, I do not know how. I know of no provision in either the Interstate Commerce Act or in Section 77 that either refers to or defines the term. We are somewhat in confusion as to precisely what is meant by that term, not being defined in the law, and what weight, if any, should be given to it. It is a term that from the standpoint of briefing some of these cases, I have given thought to it. We do not know the answer.

Director Sweet: There is a provision in Section 77 to the effect that after a plan has been approved, the Commission shall issue such authorities as may be necessary, without further proceedings.

Mr. Burgess: That is quite correct.

2912 Director Sweet: Not inconsistent with the Interstate Commerce Act. One thing that has to be done is to issue securities. The Commission has a pretty well estabilised practice in regard to the authorization of securities and it has stated in some of the cases what it means by capitalizable assets, particularly the L. & N. case with which you are familiar. We think of those things when we speak of capitalizable assets.

Q. (By Mr. Burgess.) You gave consideration to all of the elements of value, including investment in road and equipment?

A. I did.

Q. And other elements of physical value, earnings, and all the other information you had available in arriving at this conclusion, did you?

A. I did.

Q. Do you want to say anything further about the matter of capitalizing those earnings?

A. I think Exhibit No. 184 introduced at the hearing yesterday is self-explanatory and requires no further comment. I might say, however, in connection with the capitalization that in connection with the capitalization proposed in the plan, that down through the preferred stock,

2913 which includes all of the securities of par value, the par value of the securities proposed to be issued under the plan amount to $354,429,000, as shown on Exhibit A, page 9, the column next to the last, on the right-hand side, the figure being at the bottom of that column, which is headed "Five per cent preferred stock," last line, which is the total capitalization cumulative.

Q. Yesterday in answer to a question by the Director

you discussed somewhat out of order in the statement that you have been following the matter of your consideration of elements of value as reported by the Bureau of Valuation. I think that was adequately covered by the statement you made yesterday. Unless you have something further to add in regard to that, I suggest that you state your conclusions.

A. In preparing the plan of reorganization submitted herewith, many problems were encountered which, in my opinion, have been disposed of with the maximum of simplicity.

I believe the Plan is sound, feasible and workable, and while it is realistic, it is not more so than the exigencies of the situation demand in order to establish a sound, conservative capital structure under which the credit of the Debtor will be restored within a reasonable time after
2914 reorganization, thereby contributing to the restoration of railroad credit generally. To accomplish these purposes it was not possible to accord any participation to the present stockholders of the Debtor as I believe that these stockholders would be unwilling to furnish the funds necessary to liquidate the R. F. C. loans and set up adequate reserve and retirement funds, in exchange for securities junior to those to be given bondholders and general creditors, and I am firm in the conviction that to lose sight of the actualities of the situation by issuing any class of security in exchange for all or any portion of what I believe to be the worthless interests of the stockholders will unbalance the capital structure and is without justification on this record.

2915 Mr. Burgess: That completes the direct examination of Mr. Walker, your Honor. As I understood it, the several exhibits were received as they were identified?

Director Sweet: The exhibits are received unless they are objected to and the objection is sustained.

(EXHIBITS 176 to 184, both inclusive, witness Walker, were received in evidence.)

Director Sweet: In connection with what you just said, Mr. Walker, I would like to ask if you feel reasonably certain that your plan does not contemplate the issue of worthless stock certificates?

The Witness: I think the no par common stock which is given in satisfaction of the claims of the adjustment, present adjustment bondholders has some prospective value. That value is at the moment highly speculative, as

to whether or not there is value for the adjustment bondholders in the no par common stock which they receive, but I do feel that the door should not be foreclosed on the adjustment bondholders to realize in the future if there are earnings which can be properly used for the payment of dividends on the no par common stock, I feel that it would not be in the public interest to foreclose the possibility of the adjustment bondholders receiving something for their claims against this Debtor corporation.

2916 Director Sweet: Well, not only the adjustment bond-holders but some of the Milwaukee Northern consolidated bondholders, the General Mortgage bondholders and the 5s of 1975 bondholders are to get some of your no par common stock.,

The Witness: Yes, sir.

Director Sweet: Now, are you satisfied with the proposal to give to those bondholders just mentioned the common stock as proposed in addition to a 100 per cent of their securities.

The Witness: Yes, sir, because in my opinion, in order for the earnings of the property to be developed so that what now appears to be only a prospective value in the common stock, of which the security holders you mentioned receive one share for each $1,000 of their claim, the development of the property to produce the earnings necessary and required to give value to this common stock will come from funds that are possible and may be available through the sacrifices of the bondholders, holders of the bonds to which you have referred, through the A. and B. fund, through the non-cumulative features of interest and dividends which in the early years after reorganization will permit of funds being available for the development of the property.

2917 Director Sweet: Well how much, if any, are those sacrifices going to add to the value of the property that is being dealt with here or to the earning power of the reorganized company? Do they add anything in those respects?

The Witness: I believe they do. I believe they add very substantially, because the improvements which are—and betterments, or additions and betterments which are paid for out of the improvements and additions and betterments funds, which are a compulsory payment of $2,500,000, which is required and cannot be capitalized, and therefore there will be earnings sufficient after the payment of the low

fixed interest charge, a minimum of two and a half million a year going back into the property, which is not capitalized.

The plan also provides that sinking funds in the amount of $566,000 and something, over $500,000 a year will also be provided out of earnings. And if and when the forecasted earnings for the future normal prospective year become actual earnings there will be in excess of $3,000,000 a year as a minimum, going back into the property without any increase in capitalization, resulting from two and a half million actually going back into the property and half a million at least resulting in retiral. I believe that
2918 the sacrifices that are imposed by the plan and the restrictions that are placed in the plan will ultimately produce some value beyond the preferred stock. However, that is a belief which is based upon my inherent belief that the railroads of the country are essential units in the transportation system and will still continue to be so.

Director Sweet: Well, does not what you have said amount to this, that whereas you will add to the property by the expenditures from this additions and betterments fund and you will not capitalize those expenditures, as a fund and you will not capitalize those expendiures, as a matter of fact you have capitalized them in advance by the issue of this stock, haven't you?

The Witness: I would say that the stock being no par value permits these additional values which will come to the property from the improvement and betterment fund and the sinking fund, they will rebound to and represent increase in value to the no par stock. As to what value the no par stock has at reorganization, that depends upon what the actual situation is then. If it were such that the earnings at reorganization were the forecasted future average normal earnings, then I would say that that no par common stock did have some,—not value represented by earnings at that time, but it did have some value and I believe it will have from prospective earnings, and
2919 you can't put any value on it, in my opinion, based on earnings, other than a prospective value.

Examiner Jameson: Mr. Walker, we want to be clear about your plan for equipment trusts A to L. Is that precisely as in the Debtor's plan?

The Witness: In the old Debtor's plan?

Examiner Jameson: The original Debtor's plan.

The Witness: Yes, sir, that is correct.

Examiner Jameson: The Debtor introduced an exhibit, 129, which showed the principal payments and interest payments for some years to come, and I assume that that would apply and be applicable under your plan as well if you follow their plan for the trusts?

The Witness: Yes, sir.

Examiner Jameson: I just wanted to verify that.

The Witness: Yes, sir.

Examiner Jameson: That is all I have.

Director Sweet: Is there any cross-examination?

Mr. Weiss: I would like to cross-examine the witness, if your Honor please.

Director Sweet: Go ahead.

Cross-Examination.

Q. (By Mr. Weiss.) Mr. Walker, do I understand the treatment accorded by your Committee to the Terre
2920 Haute bonds rests chiefly upon the covenant against abandonment that is contained in the lease?

A. That is one of the very important and the primary objection.

Q. Well, have you been advised that in a 77 proceeding either the Commission or the Court is without power to direct an abandonment despite the provisions in that lease?

A. I don't just understand that question.

Mr. Weiss: Will you repeat it?

(Question read:)

"Q. Well, have you been advised that in a 77 proceeding either the Commission or the Court is without power to direct an abandonment despite the provisions in that lease?"

Director Sweet: Well, I don't see what that has to do with the case, a 77 proceeding has to do with this case.

Mr. Weiss: I meant a 77-B proceeding. I am sorry.

The Witness: Will the reporter please read the question?

(Question read: "Well, have you been advised that in a 77-B proceeding either the Commission or the Court is without power to direct an abandonment despite the provisions in that lease?")

2921 A. Reorganization, as I understand Section 77, if all of the railroads involved in the plan are in

bankruptcy and are under Section 77, the plan may provide for a consolidation.

Q. Well, there would not be any difficulty here, that is, if a finding were warranted, to abandon the Terre Haute System?

A. I could not say as to whether or not there would be difficulty to abandon the entire system, or to secure abandonment of the entire system; if the Trustee disaffirmed the lease then the entire system, of course, as I would understand it, could be, the Terre Haute system, could be abandoned and separated from the property.

Q. Well, considering the alternative of abandonment, would you consider the Terre Haute bonds or any part of them, the bonds of that system differently from what you have treated them in the plan?

A. Read that.

(Question read.)

The Witness: If the Terre Haute line was entirely abandoned?

Q. Yes.

A. And cut apart from the system?

Q. Yes, sir.

2922 A. Under those conditions I would imagine that the plan for the reorganization of the Milwaukee road would not include any provisions whatever for the Terre Haute System.

Q. Well, in the light of your answer why should you accord the income bonds of the Terre Haute System any better treatment than the income bonds of the Milwaukee System?

A. For this reason: That the income bonds of the Terre Haute System have their interest earned even on the basis of the handling of company coal at cost of handling. The interest on the income bonds is earned with a fair margin, good margin after interest has been paid on the other bonds which underlie the income bonds. And in addition to that, in connection with the Terre Haute, there does accrue to the Milwaukee System a distinct advantage and saving from ownership and would accrue from ownership of the Terre Haute lines, at the present time.

Q. Well, you testified to this, and it is a fact, that when the Terre Haute System was a foreign, independent line, it did not earn enough to cover its interest charges?

A. I testified, as I recollect it,—as I recollect, I testified as follows: The trustees, which are the trustees in
2923 bankruptcy, report states that before the lease to the Milwaukee the Terre Haute was a small railroad, it could not and did not get much long haul business. I further testified, as I recollect it, that if the Milwaukee discontinued purchasing its coal from mines on the Terre Haute and the Terre Haute then lost in addition to the revenues from the system fuel purchased on the lines of the Terre Haute, the commercial shipments which flowed by reason of such purchases, that it is doubtful whether the Terre Haute would earn its interest.

Q. Well, you did consider the figures prior to the acquisition by the St. Paul of the Terre Haute road, didn't you?

A. Oh, yes.

Q. And they show that they did not earn the interest on the income bonds.

A. I would not be willing to state that that is strictly the case.

Q. I think the records in this case will show that.

A. I have here an income account of the Terre Haute from 1914 to 1934, and with the exception of 1918, 1919, and the first half of 1921, the Terre Haute earned its full interest charges, and had net income after interest deduc-
tions. And the net income, after interest deductions,
2924 accumulated from 1914 to the first half of 1921, will substantially equal the losses during 1918 and 1919.

Q. Well, at least three years prior to the acquisition of the Terre Haute System by the St. Paul it had not been earning sufficient on its income bonds?

A. My recollection is that that was a period primarily of government operation, and whether or not those three years are to be taken, or that three year period is to be taken as a measure or not is a question that to my mind is very doubtful. Prior to the government operation of the road, from 1914 through 1917, the Terre Haute did have net income after interest, in every single year.

Mr. Burgess: The three years prior to Federal control became the basis for the standard return that the Government paid, did it not, Mr. Walker? I might say, Mr. Walker, that that is shown in the trustees' report, page 1803.

Q. (By Mr. Weiss.) Well, there is also a finding made

by this Commission that at the same time the St. Paul acquired the Terre Haute it was a distressed property; did you know that, Mr. Walker?

A. No, I did not; that it was a distressed property?

Q. I said, did you know that this Commission
2925 had made such a finding?

A. No.

Q. Would that alter your opinion as to the treatment to accord the income bonds of the Terre Haute?

A. No, not under the present conditions as they exist and the value that has been clearly demonstrated of the Terre Haute lines at the present time to the Milwaukee System.

Q. Well, does not an analysis of those figures indicate that this excess value, or the additional value which arises from the earnings of the Terre Haute, is largely due to the benefits which flow from its being tied up with the St. Paul System?

A. There is no doubt that that is the fact, but at the same time that benefit accrues to the St. Paul System, to the Milwaukee System, and if the Terre Haute was separated from the St. Paul the benefit which now goes to the Terre Haute and through the Terre Haute comes to the Milwaukee road would be lost, not only to the Terre Haute but to the Milwaukee road.

Q. Well, don't you think that that benefit to a greater extent should accrue to the bondholders of the St. Paul, or main system, more than you have accorded it in your plan?

A. I do not think so.

2926 Q. Well, if the St. Paul were considering today the purchase of the Terre Haute, you would not advise it, would you?

A. I don't know about that.

Q. Well, as I recall your testimony, you said that there was a serious hazard as to the exhaustion of the mines of the Terre Haute system.

A. I said that I doubted whether the mines of the Terre Haute system had sufficient reserves to last 999 years. And with the Terre Haute taken into the Milwaukee System, and the treatment that it accorded to the Terre Haute bonds, there are no maturities that begin to approach 999 years from the present time.

Q. Well, the other ownership is longer than 999 years.

A. That is very true, but with the ownership in a position to abandon, to coordinate, to consolidate, to pool with other railroads, under the lease as it exists today that cannot, in my opinion, be done.

Q. Well, aren't you in precisely that position now, that you are in a 77 proceeding?

A. No, I don't think that we are in precisely that position.

Q. Will you look at your figures and tell me when in the last seven years the St. Paul did earn sufficient money to pay anything on the 5s of '75, under your plan?

2927 A. Under the plan?

Q. Yes, your plan contemplates earnings through $14,400,000 to meet interest on the 5s of 1975.

A. Yes.

Q. Now, when in the last seven years did the road earn that?

A. In the last seven years the road did not earn that at any time.

Q. In other words, your plan—

A. That is from 1931 through 1937, if I understand that you mean that as the seven year period.

Q. In other words, if the earnings on the road do not exceed what it earned in that last seven years, there is no hope for the 5s of '75 receiving anything?

A. That is true, on account of their position in the capital structure at the present time.

Q. Incidentally, in your testimony today you referred to the income bonds which the 5s of '75 are to receive second lien on; practically they are third lien bonds, aren't they?

A. No.

Q. You even said they were on a parity with a portion of the General Mortgage bonds.

A. They are not a third lien bond, they are a second lien bond. The only liens that would probably be

2928 ahead of them are equipment trusts which are liens upon equipment leased under equipment leases, and until the equipment trusts are paid the title to the equipment does not pass to the corporation. Therefore, the bonds that they receive are—the new first mortgage bonds are first mortgage bonds and the new General Mortgage bonds are second mortgage bonds.

Q. Well, you have classified the General Mortgage bonds under your plan into two series.

A. Yes, that is true.

Q. And Series B is junior to Series A.

A. In payment of interest but not as to lien.

Q. I am talking about interest now.

Mr. Burgess: Well, you will have to tell us, because we don't know what is in your mind, Mr. Weiss.

Q. (By Mr. Weiss.) Well, it is a fact that it is third in line with respect to interest, is that correct?

A. That is correct, it follows fixed interest, interest on the Series A General Mortgage income bonds and then interest on the Series B income bonds.

Q. Now, would you say that that is fair treatment for securities which to a large degree furnished new money in the last reorganization, of approximately $70,000,000?

A. I don't think that has any bearing any more
2929 than the furnishing of money from the sale of junior mortgage bonds if expended upon the property upon which there is a senior mortgage gives the holders of junior mortgage bonds any right on a parity with the senior mortgage bonds.

Q. Well, wasn't the situation at the time of the last reorganization very much different than what you have described?

A. I don't see the connection between your question and the last reorganization.

Q. Well, at the time of the last reorganization this railroad was in an equity receivership; correct?

A. Correct.

Q. And it was in distress?

A. It was in receivership.

Q. It was financially embarrassed?

A. I imagine.

Q. Is that correct?

A. I would say that is so, it was in receivership.

Q. And if the holders of the first mortgage which are now the General Mortgage bonds had exercised their legal right they would have acquired this property free from the then junior liens, is that correct?

A. Well, that would be, offhand, my conclusion, without knowing all of the facts which might lead to some
2930 other or different conclusion, but offhand I would say yes, in an equity receivership, an equity mortgage can foreclose and take the property free from all junior liens.

Q. Well, had they exercised their legal right to acquire the road they would then be in the position of having to run that road?

A. That is correct.

Q. And to do that they would have to go out and get new money?

A. I don't know whether that is the case or not; that is not necessarily the case. We are not going out and get new money in this plan.

Q. Well, I am coming back now to 1925, you said that the situation was no different than if the railroad had put out a new issue of secondary bonds?

A. I didn't say that at all.

Q. Well, I so understood you.

A. Well, I didn't say that at all.

Q. You said that the new money that came in by virtue of the issuance of these 5s of '75 should not be treated any differently from anybody who bought a junior bond upon a new issue.

A. I said they should not be treated any different? I didn't say that. I said this: I said that the money
2931 that came in from these junior 5s of '75, which were a second lien of the reorganized company, the first refunding mortgage bonds or mortgage being ahead of the 5s of '75, that money coming from junior bonds if expended upon a line upon which there was an underlying mortgage, the expenditure of that junior money on a line, I said, and the lien of an underlying mortgage did not give the junior bondholders any position on a parity with the underlying mortgage bondholders, that is my understanding.

Q. But if this new money, putting it into the company enables this line to continue and enables it to earn interest on its senior bonds.

A. The senior bonds were not disturbed, it is my recollection, the general mortgage bonds came through the previous financial reorganization of the company without being disturbed and the interest was paid when earned.

Q. They were not disturbed because of the character of the reorganization, isn't that a fact?

A. I would not say that, necessarily. I would say that because of the fact their interest was earned and at the time they were amply and well secured.

Q. Well, wouldn't you say that it is harmful to rail-

road credit generally to treat new money the way you
2932 are treating the 5s of '75 here?

A. The 5s of '75 are not new money.

Q. To the extent of $70,000,000 they were.

A. They are not new money today.

Q. They were new money so far as the general mortgages were concerned.

A. They were new money for which second mortgage bonds of the western lines was received and a third mortgage lien on the general mortgage lines, and that was the basis upon which the new money was secured.

Q. Now, when do you expect that the earnings of this normal year will be reached?

A. They are based on the assumptions upon which the forecast was made. It would be my conception that when a business comes back to approximately the volume of business in the country generally that we have enjoyed heretofore, that we will have an increase in that volume due to the development of this country, increase in population, and that with those conditions coming about we will have these earnings, but in the meantime in my opinion if there is reorganization the fixed interest as provided in the plan can be earned and paid.

Q. Well, can you give us the year in which you estimate—

A. No, I cannot attempt to give the year.

Q. Well, would you say, then, that this forecast of earnings which contemplates some return on the 5s of '75
2933 and the other securities junior to it was rather remote?

A. I would not say whether it would be remote or whether it would be in the fairly near future, because that depends entirely on conditions which I am not able to predict, or anyone else, in my opinion.

Q. It certainly would not be justified by the experience of the company in the last six or seven years?

A. Oh, no.

Q. Now don't you think it desirable in designing any new corporate structure for a railroad to allow some room for future financing for junior issues?

A. I believe that this plan will, if business comes back as it should, as we have every reason to expect it will come back, will permit the financing through junior securities.

Q. Just where in this plan do you think earnings will come to provide for any junior issue?

A. Starting with the capital structure, the first mortgage, which is fixed interest bearing obligation, is open end.

Q. Open end?

A. Open end. So is the general income mortgage open end.

When financing comes through junior securities naturally the first vehicle of that financing would be the general
2934 mortgage. Quite naturally, unless earnings were very good, there would be a series of general mortgage bonds issued that might have priority except as to lien over the series B bonds. But that would be more to the advantage of the series B general mortgage bondholders to have a series of income bonds issued upon which the interest was contingent and with proper regulations than it would be to have first mortgage bonds issued ahead of the income bonds.

Q. And that would require earnings of at least $15,000,000?

A. That would what?

Q. That would require earnings of at least $15,000,000?

A. I would say yes, that is reasonable to suppose.

Q. Has your Committee made any study of the usefulness of the present equipment held under equipment certificates A to L?

A. I would say we have not made a study of the equipment held under specific trusts.

Q. Don't you think it would be useful in this proceeding if we had such a study made so that we would know to what extent there has been obsolescence of this equipment?

A. Personally I don't think so.

Mr. Weiss: May I ask the Commission to have such a study made of the physical condition of the equip-
2935 ment, A to L, because some of them are pretty old.

Mr. Swaine: There was such a study introduced at the time of the 1935 hearing, by Mr. Sparrow.

Mr. Weiss: Is there an exhibit on it?

Mr. Swaine: Yes.

Q. (By Mr. Weiss.) Now, in your explanation of the plan, I noticed you omitted any statement with respect to the management and the voting trust device that you provided for. Will you please give us your reasons for that and the justification for a voting trust here?

A. I feel that in the case of railroads which have gone into bankruptcy and where the creditors are called upon to make substantial sacrifices, as they are called upon in this case, that the control after reorganization should be definitely held, for a period of time, in individuals, that is, voting trustees in whom the creditors have confidence. Otherwise, if that is not the case, and the stock was simply distributed without being placed in a voting trust, control could very readily be obtained, in my opinion, for a very small cost through the acquiring of a sufficient number of shares to in effect give control. And therefore, for the protection of the creditors who are making the sacrifices, in my opinion there should be, the stock should be placed in a voting trust.

2936 Q. Well, under your plan here the preferred and common stock are divided entirely among creditors?

A. That is true.

Q. Now, under those circumstances why should these stockholders be denied the normal right of a stockholder to elect and vote for his own management?

A. For this reason that I have stated, that if that stock was distributed generally to stockholders it would be traded in on the Exchange, the value initially would, of course, not be high and control could readily pass through a very small investment. In my opinion experience shows that individual stockholders do not exercise their voting rights other than to send on proxies to those who have the management, or that the control rather produces the management, and I think that that is something that should be guarded against in every case where railroads reorganize.

Q. Well, that would be an argument in favor of depriving every stockholder of his right to vote because somebody else knows better than he what his interests are?

A. No, I don't think that is an argument that leads to that conclusion.

Q. Now, you will notice that the Debtor abandoned its position with respect to the voting trust for the very

2937 reason that under your plan control passes to creditors; are you in favor of the Debtor's suggestion there?

A. That the voting trust be abandoned?

Q. Yes.

A. Oh, no; I am firmly convinced that a voting trust is essential for the protection of the creditors.

Q. But the creditors get the voting stock, Mr. Walker.

A. I understand that the creditors get the stock, but, as I previously stated, the stock if distributed around the control could very readily be obtained without any substantial investment.

Q. You do know this, that voting trusts, especially in railroad reorganizations, have been abused in the past, don't you?

A. I would say that I know that.

Q. Well, let's go back to the history of this very road. Do you remember the voting trust of the last reorganization?

A. I do.

Q. Do you know that the voting trustees put into office a good many of the members of committees that had participated in the reorganization?

A. I know the voting trustees exercised their judgment and elected a board of directors that took control of the company.

2938 Q. And a good many of those directors were persons who participated in the reorganization, either as counsel or as members of committees?

A. They may have been.

Q. Well, that is the fact. And it is also a fact that these men—

Director Sweet: Let's let the witness testify as to the facts, or let some other witness do so. It is not proper for counsel to supply the facts.

Mr. Weiss: I started another question?

(Question read: "And it is also a fact that these men—").

Q. —were perpetuated in office throughout most of the period up to the time of the entry into 77 here?

A. The voting trustees?

Q. During the period that the voting trust was in existence.

A. The voting trust was in existence, as I recall it, less than three years after the reorganization. That was one of the fallacies of that voting trust, in my opinion, and is one of the things which worked out to make that voting trust unsound and why the term of this trust is put at ten years. That voting trust, as I recall it, provided that it would continue five years from and after a certain date,

not from and after the reorganization, and as a result
2939 of the delay in the reorganization that voting trust only continued for less than three years, according to my recollection. I think that was a fatal defect.

Q. Do you happen to know that one of the first things that this board of directors did, or the board that was elected by the voting trust in the last reorganization, was to take steps to avoid an order of this Commission?

A. I do not.

Q. Do you know that the stockholders of that company were deprived of an opportunity to remove the management and that board because of the voting trust?

A. I know that the power during the life of the voting trust to elect the board of directors was vested in the voting trustees.

Q. Now, under your plan here if this board of directors that is elected by the voting trustees should be guilty of mismanagement there is no power during the life of this trust for the stockholders to exercise their rights of ownership?

A. I do not know whether that would be the case at law or not; are you intimating gross mismanagement?

Q. Well, I am not intimating anything of the kind, Mr. Walker: All I am suggesting is this, that it is pos-
2940 sible and it has happened in the past that boards of directors have been guilty of mismanagement. Now, if that is so, why should not the stockholders exert the right that pertains to ownership of stock?

A. Well, I would say that the voting trustees, if the holders of the certificates could show that the voting trustees were responsible for management resulting in policies that were such that they could be prosecuted for following those policies, that the voting trustees, if they did not take the necessary steps to remove such men from management, could themselves be removed. It depends on what you have in mind in connection with the management, what you mean by mismanagement.

Mr. Burgess: Mr. Director, there seems to be some slight difference of view between counsel and Mr. Walker on this matter of legal argument. I wonder if it could not be reserved for brief and oral argument, so that I could get into it too.

Mr. Weiss: I think that in view of the fact—

Director Sweet: Yesterday you were willing to surrender that right.

Mr. Burgess: Well, I am willing to surrender it permanently, but I think it was a mantle that was bestowed upon me.

2941 Director Sweet: Well, proceed.

Mr. Weiss: This committee comes forward with a voting trust device.

The Witness: Yes.

Q. (By Mr. Weiss.) And I think that we ought to know all about it and why the voting right should be divorced from ownership in this particular case, and I should like to develop all of the facts with respect to it.

Director Sweet: Well, if you will develop the facts we won't have any quarrel about it.

Q. (By Mr. Weiss.) Has the committee discussed who these voting trustees shall be?

A. They have not.

Q. Have you anybody in mind?

A. We have not.

Q. When do you expect to announce the names of these voting trustees?

A. The plan provides here that—

Q. Can't you tell me when?

A. I would say, after the plan comes from the Commission that then would be the time for the names to be announced, unless it was desired prior to that time that the personnel of the voting trustees be fixed. It is immaterial, it seems to me. The voting trustees under this plan and under a plan that would come from the Commission,

2942 the Commission is in a position in its plan which it brings out to put such restrictions and conditions upon the approval of the trustees or their examination into their fitness as it desires.

Q. Well, will your committee be prepared, then, to make such an announcement before the Commission takes this plan into consideration?

A. No.

Q. Is it your intention, then, to keep that a secret?

A. No secret about it, because we haven't in any way considered the question of who should be suggested by our committee as the voting trustees.

Mr. Weiss: That is all.

Mr. Abrams: May I continue with a few questions?

Director Sweet: Proceed.

Q. (By Mr. Abrams.) Mr. Walker, you are interested in getting approval of a fair and equitable plan, aren't you?

A. Yes, sir.

Q. You would not want this Commission or a Court to approve a plan that is not fair and equitable to all classes?

A. No, sir, I would not desire that they approve any such plan as you suggest.

2943 Q. Do you consider a plan fair and equitable which is only fair and equitable to one class of securities and not to the others?

A. I consider a plan is fair and equitable that accords fair and equitable treatment to all classes of creditors and to stockholders.

Q. Now, your plan is predicated upon announced principles that you have stated in your plan, being numbers A to G, inclusive, is that correct?

A. That is correct, pages 6 and 7, as shown in the plan.

Q. Now, I direct your attention to principle in subdivision B "Priorities as between classes of creditors should be preserved, with mortgage lien creditors having a call upon the property and its income prior to unsecured creditors." Have you followed that principle in adopting this plan?

A. I believe it has been followed, is substantially followed, without any qualification, but with some possibly slight modification made necesary by the conditions existing in this case.

Q. Now, have you followed, or you didn't follow, can you answer that yes or no?

A. Substantially it has been followed.

Q. Now, do you consider a change in the position of a secured creditor to that of the holder of worthless
2944 common stock, do you consider that as placing that secured creditor in the same position?

A. I did not say in the same position. Under the conditions existing in this case probably that is equitable treatment for that creditor, if at the present time he is a secured creditor but so far down with respect to the priority of his lien that after those creditors with prior liens are satisfied there is nothing left to satisfy the most junior of junior lien creditors except stock.

Q. Well,—

Mr. Burgess: I am sure, Mr. Abrams, you did not use "worthless common stock" as describing any of the stock that we propose to issue under this plan.

Mr. Abrams: Yes, I am describing it as worthless.

Mr. Burgess: You did not describe it that way, did you, Mr. Walker?

The Witness: No.

Q. (By Mr. Abrams.) Mr. Walker, don't you consider a secured junior creditor in the position of a secured creditor to the extent of the security, and a general creditor for any deficiency in all of the other assets which are not secured by the mortgage, don't you consider such a creditor in such a position?

Mr. Burgess: Is that question clear to you, Mr.
2945 Walker?

Mr. Abrams: I don't know whether it is clear to you or not, but the witness can answer.

Mr. Burgess: Well, the difficulty was that it wasn't clear to me.

Mr. Abrams: Will you read my question, Mr. Reporter?

(Question read: "Mr. Walker, don't you consider a secured junior creditor in the position of a secured creditor to the extent of the security, and a general creditor for any deficiency in all of the other assets which are not secured by the mortgage, don't you consider such a creditor in such a position?").

Mr. Abrams: Do you understand that question?

The Witness: The question is not entirely clear.

Q. Well, if it isn't entirely clear, let me make it clear to you.

A. Yes, I was just going to say—

Q. Let me make it clear to you.

Isn't it a fact that a junior security holder is a creditor having security to the extent of the junior security, and for the balance of his lien he comes in the capacity of a general creditor to the extent of the available assets above the mortgage security?

A. I believe that a secured creditor, that his claim be-
comes a claim on a parity with other general creditors
2946 to the extent that it cannot be satisfied by the security upon which it may have or the creditor may have a lien.

Q. Now, when under your plan you exchange the ad-

justment bonds for common stock you thereby deprive the adjustment bonds of their junior security and you deprive them of their position of general creditors, and you relegate them to the position of common stockholders, is that correct?

A. Oh, no, I wouldn't say that was a correct analysis of it. I would say that the adjustment bondholders are in a position in this instance of junior secured creditors and that in satisfaction of the creditors senior to the adjustment bondholders all of the debt, secured debt, which can properly be placed on the property and included in the capital structure has been exhausted in satisfying the claim of the senior creditors, and in addition to that the preferred stock has been exhausted. And coming down the line we now, unfortunately for the holders of the present adjustment bonds, have reached the position in the capital structure where the equity in the property passes to the adjustment bonds. There isn't any other way, as I see it, to give to the adjustment bondholders a different type of security in this capital structure.

2947 Mr. Abrams: May I ask that this answer, which is not responsive to the question, be stricken, and that the witness answer the question.

Director Sweet: Your request will be noted. Let us proceed.

Q. (By Mr. Abrams.) Under your principle No. C you say, "The public interest requires that all deferred and defaulted interest on debt up to the time the reorganization plan is made effective shall be recognized with the principal of the debt"—

A. Yes.

Q. What public do you refer to?

A. I refer to the general public interest, the general public interest being the requirement that mortgage debt and the obligations of trust indentures and the right of holders of obligations under those trust indentures be fully recognized.

Q. Do you refer in this public to future investors or past investors?

A. I refer to all investors, past, present and future, or prospective.

Q. And do you consider in that public persons who have advanced their funds in the purchase of the junior securities and the worthless stock which you are now wiping

out under this plan, are they included in that 2948 public?

A. I believe they are included in that public, and this provision that their principal and interest, or the interest should be accorded the same treatment as the principal to which it relates.

Q. Now, are there any assets in the system which are not pledged under any mortgages and which are available to general creditors?

A. I do not believe there are assets of any great value that are not pledged under mortgages or loans, and of course there are, when you come right down to it, deficiencies in satisfaction of claims that are senior to the 5s, the adjustment 5s, that would rank equally with the adjustment 5s as general creditors if those assets that were free had any great value.

Q. Has your committee made a study of all of the free assets which are not subject to any mortgage?

A. I would say that we have examined the balance sheets and also what we considered to be information with relation to free assets and reached the conclusion that there were no free unpledged assets of any substantial amount of value. It looked to us as though substantially all of the assets had been pledged either under the mortgages or—

Q. Do you know how much cash on hand the rail- 2949 road has now?

A. $10,000,000, I believe, December 31, 1937.

Q. Well, is this $10,000,000 secured by any mortgage?

A. No, but it has been earned by mortgage liens.

Q. I didn't ask you about how it had been earned, I asked you if it is secured by any mortgage.

A. I have an idea, which I would like to possibly verify—

Mr. Abrams: May I ask of the Commission that the witness be directed to answer the questions and not give me any of his ideas.

Mr. Burgess: Well, there is a segregation order of the Court.

Director Sweet: The witness probably can explain his position. He can answer the question and then explain his position.

Q. (By Mr. Abrams.) Have you answered my question

whether that $10,000,000 in cash was now subject to any mortgage?

A. It would be subject to the mortgages if the mortgages contained provisions under which the income also is pledged.

Q. Well, did you read the mortgages, do you know the provisions contained in the mortgages?

A. I personally have not read all of the mortgages.

2950 Q. Now, general creditors would participate in this $10,000,000 fund if your plan is not adopted, is that true?

A. I don't think so.

Q. You mean to say that if there is a $10,000,000 fund which is not pledged by any mortgage that general creditors would not participate in that fund, is that what you mean to tell?

A. I mean to say that if there is working capital that has come from the earnings—

Q. I have not made any reference to working capital. Will you answer my question?

Director Sweet: Mr. Abrams, aren't you indulging in a legal argument now? Can't you ask this witness about what he has shown and why he has shown it?

Mr. Abrams: I am trying to get this witness to answer questions, but he is getting into the legal argument.

Director Sweet: But you are asking questions that are arguable, there is no doubt about that, and they are arguments upon legal questions that ought to be avoided; our record is pretty long now.

Mr. Abrams: I see that, and if this witness will answer the questions and not argue them, that will avoid a lot of record in this hearing, a lot of unnecessary

2951 record.

Director Sweet: Let's take time to think it over. We will be in recess now until 2:00 o'clock.

(Whereupon, at 12:35 o'clock p. m., an adjournment was taken until 2:00 o'clock p. m. of the same day.)

Afternoon session—2:00 o'clock p. m.

Director Sweet: You may proceed, Mr. Abrams.

FREDERICK W. WALKER testified further as follows:

Cross-Examination (Continued).

Q. (By Mr. Abrams.) Mr. Walker, I call your attention to the collateral pledged with the Reconstruction Finance Corporation loan as shown by your Exhibit No. 172 and will ask you if your study shows that the general mortgage bonds aggregating $11,212,000 have enough assets security behind them to make it a valuation of the face amount of the bonds?

A. No, the valuation of the collateral represented by the general mortgage bonds is not the face value of the bonds.

Q. What do you consider the valuation of the $11,212,000 of bonds to be?

2952 A. I consider the value to be 60 per cent of new first mortgage bonds which would flow that that collateral—

Q. Suppose you will forget about your new mortgage bonds; what do you consider in dollars and cents is the value of these $11,212,000 in bonds?

A. I was going to endeavor to tell you what I considered to be the value.

Q. And in determining the Reconstruction Finance Company had ample security didn't you arrive at the valuation of the collateral?

A. I did.

Q. Well, what valuation did you arrive at the $11,212,000 to be?

A. I arrived at a valuation of 100 cents on the dollar for 60 per cent of the face value and approximately 50 cents on the dollar for the remaining 40 per cent.

Q. Well, will you, I ask you to forget anything about your plan, I ask you whether you have valued the actual valuation of these bonds and what it is, in dollars and cents?

A. That is the way I value it, and that is what I figure is the value of those bonds.

Q. Well, if this second mortgage, or rather the gen-

eral mortgage, would be foreclosed, how much do you
2953 think in dollars and cents would it give at a foreclosure sale?

A. I couldn't say.

Q. You haven't estimated it at all in arriving at your figures?

A. No, because it can't be foreclosed under Section 77.

Q. Well, assume that Section 77, that the proceedings here will be dismissed and that you would have to foreclose that mortgage, how much in dollars and cents would you realize in foreclosure?

A. I do not know.

Q. So that your plan is not predicated on the actual value of these bonds?

A. I believe it is, but it is not predicated on the basis of a foreclosure sale.

Q. Well, your plan is predicated on beliefs and not on estimates and figures?

A. No, it is predicated on estimates and figures which represent my belief.

Q. How much did you estimate to be the value of the $6,000,000 of first and refunding mortgage bonds deposited as collateral?

A. I figured that those first and refunding mortgage bonds that are deposited as collateral, by reason of
2954 the lack of earning capacity from operations, was represented by the capitalization at 5 per cent, as stated, of the income received from the collateral pledged under the first and refunding mortgage.

Q. Mr. Walker, can you answer in plain words how much did you value the $6,000,000 first and refunding mortgage bonds at?

A. My valuation of them as heretofore stated was about $8,000,000.

Q. You mean the $6,000,000 in bonds was valued at $8,000,000?

A. Yes, due to the collateral and due to the fact of the six million of bonds represented in outstanding bonds under the first and refunding mortgage.

Q. Now, did you estimate the equity in the collateral deposited with the Reconstruction Finance Company under the $11,000,000 loan and how much that equity would be above the amount of the loan?

A. I figured there would be substantially nothing left over and above the amount of the loan.

Q. And then you mean to say that the Reconstruction Finance Company which has assets in excess of twenty million for a loan of approximately $11,500,000 has nothing above the indebtedness as collateral, is that what you mean to say?

2955 A. Substantially nothing left.

Q. Is that based on an actual appraisal or a mere guess?

A. That is based on an estimate, taking into consideration what I believe to be the values that go to make up the valuation of the equity.

Q. Did you have any expert to give you an opinion as to the value of these securities?

A. No.

Q. Did you ever order an appraisal as to the value of these securities?

A. No.

Q. And does your plan if there be any equity above the loan the equity would be canceled so the general creditors would not receive anything out of their equity, is that correct?

A. Just read the question, please.

Mr. Abrams: Will you read the question?

(Question read.)

A. I don't just understand that, to be quite frank.

Q. (By Mr. Abrams.) You can't answer that question?

A. I do not understand just what the question means.

Q. Well, I will make it plainer: Suppose it should appear that there is an equity in the collateral above the loan, would the general creditors receive anything

2956 in that equity under your plan?

A. No.

Q. So you wipe out that equity under the plan?

A. No, the equity is not wiped out. I feel there is no equity that flows from the first and refunding bonds or from the collateral under the R. F. C. loan.

Q. How did you arrive at the conclusion that all of the collateral under those loans is not worth more than the amount of the loans?

A. As I have stated, the first and refunding bonds with respect to earnings from the operation of the lines west, or the lines upon which it has a first lien, there is no value there as an operating property after charging against the operations the various items to which I have testified. And the collateral which is deposited under the loan has a

value, based on capitalization of the income which flows, and that goes to the satisfaction of the loan. Now, looking at the collateral pledged, I feel that there is substantially nothing that goes from this collateral to the general creditors, and if there should be something left over then it is a matter of what general claims there would be. I do not think there is anything left myself.

Q. Would any of the mortgages where you give them 100 per cent under new securities realize the full
2957 value 100 cents on the dollar if those mortgages were foreclosed in an equity proceeding?

A. I could not say.

Q. You haven't at all figured on that?

A. No, sir.

Q. It makes no difference under your plan whether the owners of those mortgages would realize 20 or 30 or 50 cents on the dollar or 100 cents on the dollar for the purpose of giving them new securities on the basis of 100 cents on the dollar; that is correct?

The Witness: Read the question, please.

(Question read.)

The Witness: You mean in the event of equity receivership and foreclosure?

Mr. Abrams: In any event.

Mr. Burgess: How about no event?

A. I can't say what they would receive in any event, and the plan does not provide for a realization of assets.

Q. (By Mr. Abrams.) How would you expect to realize any money on any of the mortgages which you are treating here as 100 per cent on the dollar if the 77 proceedings should be abandoned, how would you collect that money?

A. I do not know at the present how I would col-
2958 lect the money.

Q. So your plan giving 100 cents on the dollar to those security holders is not predicated on the collection basis?

A. It is not.

Q. Now, is it also true of the general mortgage?

A. It is true of every mortgage in connection with the plan, it is not based—

Q. So that your—

A. —the plan is not based on a sale or a realization of assets.

Q. So that your plan is not predicated on anything

which any of the mortgage property would yield to the lien holders?

A. I wouldn't say that. The plan is predicated, as it is shown here, on the basis of income in the allocation of securities that would flow to the lien holders.

Q. Now, you have enumerated certain sacrifices that the institutional owners of these bonds, the first mortgage liens are making to carry out this plan and for these sacrifices you intend to, in the future mortgage, to cover after acquired property, is that correct? That is what you testified, isn't that true?

A. I didn't testify, as I recollect it, that the provision for the after acquired property, the broad clause,
2959 was to compensate for sacrifices now made.

Q. You didn't testify so?

A. I think not.

Q. That is your best recollection?

A. My recollection is that I testified that that was to protect them against losses and impairments of the security of their bonds in the future.

Q. Do you know if any of the mortgages contain such provisions now?

A. Any of these mortgages?

Q. Of the existing mortgages?

A. I could not state whether or not definitely the after acquired property clause in these particular mortgages are as broad as this clause.

Q. So that you do not know whether or not any of the after-acquired property subsequent to the execution of the existing mortgages was covered by the mortgages?

A. Do I know that after-acquired property clauses are in the mortgages?

Q. In all of the mortgages?

A. At least in the general mortgage and in, I believe, a number of the other mortgages, but as to whether the after-acquired property clauses are as broad and all-inclusive as the clause appears in this plan, I do not know.

2960 Q. Now, have you requested a list of all of the property which is owned by the Debtor which are not subject to mortgages?

Mr. Burgess: You asked that question this morning, Mr. Abrams; you promised me you would get through pretty soon.

Mr. Abrams: I asked him if he requested such an estimate.

The Witness: Have I what?

Mr. Abrams: Have you requested such an estimate of the carrier?

The Witness: I have not.

Q. (By Mr. Abrams.) And you haven't any idea of what it is?

A. Well, I have an idea, but I have not requested a statement, and therefore I cannot say in detail just what that is.

Q. Now you realize, though, that under your new plan the general creditors and the adjustment bond owners would be relegated to stockholders and they will therefore not be, any equity that they may have in any of the assets that are not pledged under any of the mortgages, you realize that?

A. I would not state that that would be so, depending upon the nature of the assets not pledged.

Q. Now, under your plan you are giving the pre-
2961 ferred stock and common stock to the owners of the general mortgage and to the owners of the 50-year mortgage; have you figured up the total of the stock that will be received by the lien holders above the stock to be allotted to the adjustment bonds?

A. That is shown in detail, but if I understood you to say that the general mortgage bondholders were receiving preferred stock and common stock, I would say that the general mortgage bondholders under the plan I believe receive first mortgage bonds and general mortgage income bonds Series A, and some common stock.

Q. But that is not what I am driving at. Let me make it plain to you. Perhaps I did not.

A. No.

Q. Under your plan the preferred stockholders and common stockholders have an equal vote, isn't that right?

A. That is right.

Q. Now, under your plan you are giving approximately 253,000 shares of stock to the owners of the general mortgage bonds, is that correct?

A. One hundred and fifty thousand.

Q. One hundred and fifty; then you are giving also about 124,000 to the 5s, isn't that right?

A. That is correct.

Q. That is correct. And then you are giving about
2962 5,000 of those shares to another class of creditors?

A. That is correct.

Q. So that when you total up all of these stocks you will have approximately two to one as against the stock that you are going to give to the adjustment bondholders?

A. Oh, no, oh, no.

Q. It is not?

A. No. The adjustment bondholders receive 2,578,000 shares, so that they receive in the neighborhood of approximately 10 shares of common stock to 1 share that is given to these other creditors that you mentioned.

Q. But isn't the total stock, preferred and common, that you are giving to all other creditors more than what you are giving to the adjustment bondholders?

A. No, no, it is not, sir. They are given preferred stock, there is outstanding 782,000 shares.

Q. Yes.

A. There will be common stock given to these creditors that you have referred to.

Q. Yes.

A. In the amount of approximately 283,000 shares so that in preferred and common stock; adding the shares together, there will be approximately a million shares given to outstanding holders; and the adjustment bonds 2963 received 2,578,000 shares, or two and a half times the amount of stock, common stock, or two and a half times the shares of stock, each of which is entitled to a vote, that is given to these other creditors.

Q. Now you intend under your voting trust that the committee is to name two and two will be named by the owners of the preferred and common stock, which will include approximately over a million of stock to be held by the same group, isn't that correct?

A. That is correct.

Q. So that your plan, which on the face of it gives the preferred and common stockholders the choice of naming two voting trustees, actually in fact give the choice to your committee or to the institutions that your committee represent?

A. That might work out that way.

Q. Well, why didn't you say it in plain words so that everybody should know it?

A. I think that it is properly expressed in the plan.

Q. Now, under your plan you are giving to the general mortgage bondholders 60 per cent in new first mortgage bonds and 40 per cent in what you call general mortgage on a second mortgage so that, realizing that the first

mortgage bonds and the second mortgage bonds will go to the same party, then they are actually getting 100
2964 cents on the dollar for their investment, isn't that right?

A. They are getting 100 cents on the dollar par value in mortgage bonds.

Q. Well, that is all they have now in mortgage bonds, isn't it?

A. Yes, but now they are first mortgage bonds, and what they are getting—and it is first mortgage bonds of the Debtor on the system, while in this case they are ahead of them, or rather on a parity with them—first mortgage bonds that go to the loans, or first mortgage bonds that go to the first mortgage of the Milwaukee & Northern, and so they receive, as I previously stated, first mortgage bonds to the extent of 60 per cent, and second mortgage bonds to the extent of 40 per cent.

Q. When you are the owner of the first mortgage and you are the owner of the second mortgage, does it make any difference to you whether you have a first or a second mortgage?

A. Oh, yes, it would make a great deal of difference whether I had a first or a second mortgage.

Q. You mean if the same person held the securities it makes a difference?

A. I would say so, yes, because having a first mortgage, with the first mortgage, and having a second
2965 mortgage, the first mortgage bonds would be more readily salable than the second mortgage bonds, and in the event of future financial difficulties the first mortgage would be in a much more advantageous position, and furthermore in connection with these first mortgage bonds the interest is fixed while the interest on the second mortgage income bonds is contingent, and ahead of that interest is two and a half million of improvement and betterment bonds.

Q. Can you tell why you call your second mortgage a general mortgage and why you don't call it by actual name?

A. Well, maybe it would have been better or as good to call it a second mortgage. It sets up no claim to a first mortgage lien, it is a general mortgage. If it appears to be a more desirable name for that mortgage to call it a second mortgage income bond, why I can't see any objection to calling it a second mortgage income bond.

Q. In your first plan that you presented you allowed

4½ per cent interest on Series B of the general mortgage; your modification changed it to 5 per cent.

A. That is correct.

Q. Can you tell us why this change?

A. I testified, as I recollect it, that the change was made after further examination and consideration in
2966 order that the 5s of 75 which receive the Series B bond should be compensated somewhat for the interest on the Series A by having priority.

Q. So you figure that this is compensation?

A. I figured, as I said, that it somewhat compensated the 5s of 75 for the interest on the Series A having priority. I also stated, as I recall it, that I had some doubt in my own mind as to whether those 5s of 75, the treatment accorded them was not possibly better treatment than they were entitled to receive.

Q. Now, your whole plan is predicated upon prophecy or a forecast as to what will happen in the future by reason of the growth of the country; if that prophecy should not materialize then of course you would need another reorganization, wouldn't you?

A. If that doesn't materialize, and if the future development is such that the very small fixed charge which is placed against the property, that is, for the average anticipated minimum earnings that will occur in the future prove to be—that average proves to be too high and the earnings then are not as great as the fixed charge which has been set up, but is less than those minimum earnings, then there would be in the future another bankruptcy, but to avoid that possibility the general mortgage income
2967 bonds follow the first mortgage fixed interest bearing bonds, and I believe that this system in the future will have the minimum earnings at least that have been set up in the plan.

Q. In the event of the mability to meet the fixed interest charges under your plan, the first mortgage bondholders would have the right to foreclose and wipe out all other interest or securities that you are issuing subsequent to that mortgage, isn't that right?

A. If the property was thrown into receivership, that would be correct. If the property was thrown into bankruptcy then the trustee under the mortgage would be stayed from exercising the remedies.

Q. You are positive that the income would be sufficient to pay the fixed interest charges under your plan?

A. I believe so.

Q. Well, why didn't you provide an income bond for your first mortgage instead of a fixed interest rate and avoid the possibility of a foreclosure or another reorganization in the near future in the event of a default?

A. Primarily for this reason, that in my opinion if the capital structure of the railroads and of the system similar to and of the magnitude of the Milwaukee System, had merely income bonds, that the funds of institutional
2968 investors would not flow into those securities and in my opinion financing of the railroads is dependent upon individual investors and institutional investors. Both are important.

Q. And your institutional investors have already invested their money in this enterprise, is that right?

A. That is true.

Q. You don't intend to sell these securities now to the institutional investors?

A. That is also true, but the future will require further financing.

Q. So it wouldn't make any difference then to the institution that you represent and to the present investors if you had provided for an income bond instead of a definite fixed interest rate as long as you are sure that the income will be sufficient to pay the interest?

A. It would make a difference, and it would make a difference for this reason, among others: That securities that do not bear a fixed interest rate must be carried in the assets, and under the laws regulating the value of the assets of life insurance companies. They must be carried in the assets at market value and market value is a fluctuating value. The securities bearing a fixed rate of in-
2969 terest and a definite maturity, if amply secured and not in default, are carried on an amortized basis. That is, if purchased at a premium the premium is written off annually in equal amounts to maturity, and if purchased at a discount that discount is written in annually so that at maturity the investment being made to hold to maturity the security is in the assets at par value.

Now, under he method of valuing assets, which I believe is eminently sound, securities in any considerable volume in the investment portfolio which fluctuate on a basis of market prices is very undesirable from the standpoint of institutions of the type of life insurance companies.

Q. Has your committee made an appraisal of the actual

value of the assets of the debtor in arriving at the conclusion that adjustment bonds should be given stock and that the preferred and common stockholders should be completely wiped out?

A. No.

Q. You have not?

A. We have made no such appraisal.

Q. So that your plan is not predicated upon an actual valuation of the property?

A. Not on any appraisal of the property that has been made by the Committee.

2970 Q. Do you think then that it is fair and equitable to ask the Commission and the court to approve a plan which wipes out such large interest without even ordering an appraisal of the property?

A. My own feeling is that an appraisal of the property in this instance is not necessary because under Section 77 of the Bankruptcy Act it states that only such value shall be given to the property as should be placed upon that property in the light of the earnings.

Q. You are now—

A. (Continuing.) And the situation, as I see it, is this, that there isn't in this property a sufficient value, and value, in my opinion, is primarily determined by the ability to pay an income on that value—

Q. Your plan is predicated—

A. Just a minute.

Mr. Abrams: You are not through?

The Witness: No, sir.

Mr. Abrams: Go ahead.

The Witness: There is not a sufficient value there to leave anything for the stock, preferred or common.

Q. And your plan is predicated upon that construction of the legal effect of Section 77, is that right?

2971 A. No, my plan is predicated upon what I believe to be fair and equitable relative value to this system of the different mortgage districts.

Q. Do you know whether it was the intent of Section 77 to give to creditors in exchange new securities for the full value of the old securities, for the full fixed value of the old securities, regardless of the fact whether or not the securities are worth the face value thereof?

A. I do not think I could say what was the intent of Section 77 with respect to that matter. I think that is a

question that could possibly be answered better by others than myself, but—

Q. Well, if you can't answer we won't have to go on any further.

A. All right.

Q. You know, though, that under Section 77 the law allows classes of creditors to scale down the indebtedness, if the required number agree and the Court approves of it, you know that to be a fact?

The Witness: Read the question, please.

(Question read.)

The Witness: I cannot say that I know that to be a fact.

Mr. Marsh: Isn't there any way that this could be
2972 deferred to argument. There are many of us here having other cases that we need to attend to, and it is terrible to sit here hour after hour and hear these questions which are nothing but argument; it isn't adding anything to the case.

Director Sweet: Have you about concluded, Mr. Abrams?

Mr. Abrams: I am about through. In fact, this is my last question.

Director Sweet: The objection is good, but it came a little too late.

Mr. Marsh: Yes.

Director Sweet: Do you wish to cross-examine, Mr. Marsh?

Mr. Panteleoni: I have a few questions to ask, but they are all questions which are asked for the purpose of laying a foundation for a motion which I hope to make shortly and which I hope your Honor will accord me the privilege of arguing perhaps five minutes before you decide it.

Q. (By Mr. Panteleoni.) Mr. Walker, whom do you represent, you and the Committee?

A. We represent a group of institutional investors, bona fide holders of securities of the Milwaukee Railroad.

Q. And you have set forth the interest which those
2973 institutional investors hold in your Exhibit No. 176?

A. I have.

Q. There is no common or preferred stock in those holdings?

A. There is not.

Q. Therefore of course you do not purport to represent the common stock or the preferred stock?

A. I do not.

Q. What treatment does the plan accord for common and preferred stock?

A. They are excluded from the plan.

Q. Correct. Did you discuss that exclusion with any representatives of the common or preferred stock?

A. I did not.

Q. Did any member of the committee, to your knowledge?

A. Not that I know of.

Q. I also note, to save time, rather than to ask the question, I simply will summarize, I note that the holding consists of $46,000,000 of general mortgage bonds and $13,000,000 of equipment trust certificates; if to those you add the other holdings, the other bonds which granted exclusively first mortgage bonds under the plan, I think you get a total of $64,000,000 out of the total holdings of the Committee of $83,000,000, and I think that that would represent something like a percentage of 78 per cent,

2974 is that approximately correct?

A. I would assume that to be so.

Q. Subject to correction by someone?

A. Subject to correction.

Q. Correct.

A. By checking from the exhibit.

Q. That is right. Now, would it be a fair statement to say that the interests of the Committee are primarily the interests of the general mortgage bondholders?

A. I would say that it would be a fairer statement to say that they are primarily the interests of underlying bondholders.

Q. Of underlying bonds?

A. Yes.

Q. I think that is a fair statement.

A. Yes.

Q. Now, you are familiar with the 1935 plan, to a certain extent?

A. Yes, sir.

Q. Your Committee approved that plan?

A. We, as I stated here, said that in the light of the situation as it existed and on the basis of an early reorganization, that the members of the Committee would recommend to the various institutions that they should accept the plan.

2975 Q. That continued to be your opinion until when: I say "your"; I mean the Committee's; that continued to be your opinion until about what date?

A. That continued to be my opinion until the hearing in September of 1937, when testimony before the Commission in this matter by the Debtor set up that it was not—

Q. That answers my question. Now, the 1935 plan was prepared, I believe, as the result of a great many conferences, and certainly from the time it was proposed until September, 1937, there were a great many conferences between the Committee and trustees of other issues, the board of directors of the Debtor, and other parties interested, is that correct?

A. I would say that is correct, except possibly as to stating that there were many conferences with the trustees of other mortgages.

Q. Right, but you did have conferences with representatives of other issues, or people purporting to represent exclusively other issues?

A. Right.

Q. By "other issues," I mean other than underlying bonds.

A. As to other members of the Committee I do not know as I would be justified in saying that there had been
2976 any material number of conferences with representatives of investors holding other securities.

Q. There were numerous hearings down here?

A. Yes, sir.

Q. At which representatives of these other non-underlying issues were present?

A. That is true.

Q. Now, I note in that list of securities on Exhibit 176 that the Committee holds $10,900,000 of 5 per cent convertible adjustment mortgage bonds representing 5.67 per cent of the outstanding issue.

A. Yes, sir.

Q. I take it that you have not discussed the plan which was filed on January 10, 1938, with any representatives of that issue?

A. I have not.

Q. And by "you," including members of the Committee, of course, to the best of your knowledge?

A. To the best of my knowledge and belief.

Q. And I take it the same answer would be made with respect to the Gary bonds, so-called?

A. That is true.

Q. And likewise with regard to the 5 per cent bonds of 75?

A. That is also true.

2977 Q. Now, the 1935 plan did not provide for a change in any of the liens, did it?

A. Not as to lien.

Q. That is right. The first proposal with regard to a change of lien was in the plan filed on January 10th, or the first since the filing of the 1935 plan?

A. I believe that is the case.

Q. And you have testified that there were no discussions with representatives of the junior interest in regard to that change of lien; I refer you to Exhibit 181, how did the Committee prepare Exhibits 139 and 140, I am taking the first column at the top there.

A. Now, that exhibit was prepared by the Debtor.

Q. And that same answer, I take it, would apply to the next column, Exhibit 141 and 142?

A. That is true.

Q. And so for the next column, Exhibit 144?

A. That is true.

Q. And so for the next column, 145 to 146?

A. That is true.

Q. Those exhibits were prepared and filed in connection with the 1935 hearing, were they not?

A. Correct.

Mr. Panteleoni: Well, strike that question.

Q. They were filed before the abandonment of the

2978 1935 plan, in September of 1937.

A. I am not certain whether the last of those exhibits were filed—I think that is correct.

Mr. Swaine: I did not know that the 1935 plan had been abandoned.

Mr. Panteleoni: Well, I was taking the words out of the witness' mouth. Then I am sorry.

Mr. Burgess: I didn't know that it hadn't been.

Mr. Panteleoni: I leave it to your Honor. The witness is testifying here; we will take his word for it, and go on.

A. I think my wording of it was that in September, 1937, the Debtor testified that at that time the plan was no longer practicable, in its opinion.

Mr. Panteleoni: I see. Well, then, the words "no longer practicable" we want substituted for the word "abandoned."

Q. (By Mr. Panteleoni.) Did the Committee subsequent to September of 1937 go into the detail upon which any of those exhibits are based with officers of the Debtor?

A. Yes.

Q. Are you at all familiar with the details underlying Exhibit 145 and Exhibit 146, those are the exhibits differentiating income and expenses from the lines west.

A. I am, to the extent that in connection with the formula upon which that allocation or estimate was
2979 made, I did discuss that with representatives of the Debtor and as to the effect upon the various items in the income account.

Q. You know of no general determination of a formula for this particular railroad?

A. Unfortunately not.

Q. And there are no formulas that have ever been proposed or prepared by anyone for any other year than 1936?

A. That formula, as I understand it, or these formulas are not prepared for a particular year, but the formulas themselves were applied to particular years.

Q. Well, I am not sure that I understand. Are there any actual divisions and allocations of earnings and expenses between the various mortgage divisions made for any year except 1936?

A. I believe there was some made for some previous years.

Q. At any rate, they are not in evidence in this proceeding?

A. I think they are in, certainly with respect to certain lines.

Mr. Panteleoni: If someone knows or could answer that to refresh the witness' recollection.

Mr. Oliphant: The years 1930 and 1931.

Mr. Panteleoni: 1930 and 1931?

2980 Mr. Oliphant: Yes.

Q. (By Mr. Panteleoni.) Now, there was no study made particularly of the allocation to the lines covered by the general mortgage?

A. There was not.

Q. In the allocation of income and expenses for the first and refunding mortgage what credit was given for the pledged securities under the first and refunding mortgage?

A. The income received from those securities.

Q. Only the income received?

A. Yes.

Q. No credit was given for any value in those securities?

A. Not in an allocation of earnings.

Q. Was any credit given to earnings, potential earnings?

A. Not in those allocations, no, sir.

Q. Was any credit given for the equity in earnings from the Terre Haute line?

A. There was not.

Q. Do you know whether or not any credit was given in the prorate of revenues between lines west and lines east for origination of traffic?

A. I think not.

Q. Do you know whether or not the prorate was an
2981 actual prorate month by month, or whether it was estimated?

A. The testimony will show, in the record, the extent to which actual way-bills were examined, and the estimate was made in an examination and study of the actual way-bills and the revenue from those way-bills.

Q. But I take it you as a Committee did not examine into the details of the preparation of those allocations?

A. I did not go into the actual working papers and we did not, as a Committee, no, and neither did I as an individual.

Q. Well, I did not mean to restrict it in that sense, I mean your staff, did you go into it?

A. We did not go into the details of the actual working papers of those estimates. We did, however, examine the formula, the respective formulas, and we also did examine and inform ourselves as to the bases upon which those formulas were applied, but we didn't go into the working papers in connection with it.

Q. And to your knowledge there were no representatives of the particular issues interested present when the particular formulas referred to in these schedules were adopted?

A. I have no knowledge of any representatives
2982 being present.

Q. Now, I ask you to think back to the 1935 plan for a moment; the 1935 plan I believe left liens undisturbed.

A. That is my recollection of it.

Q. Right. It also provided for two-thirds fixed interest, speaking roughly, on the general mortgage bonds, and one-third made contingent was cumulative; is that your recollection?

A. That is my recollection, and fully cumulative.

Q. Fully cumulative?

A. That is correct.

Q. I wonder, perhaps, could you do it this way, could you point out to me what you consider to be the extra sacrifices which are now being made by the general mortgage bondholders as compared to the sacrifices offered by them in the 1935 plan.

A. I would have to do that from my recollection.

Q. Of course, and I do not mean to go into too much detail.

A. I will endeavor to do it to the best of my ability, from recollection. In the 1935 plan, during the standby period, the lien of the general mortgage was disturbed, and the general mortgage bonds were to draw two-thirds fixed interest and one-third contingent interest, fully cu-
2983 mumlative.

Q. May I interrupt just a moment: The lien at that time of the general mortgage did not include the Western lines or the pieces east covered by the first and refunding?

A. It did not.

Q. I see. Now go right ahead.

A. In the new plan the general mortgage surrendered a full first lien position and accepted a first and a second lien position.

Q. May I interrupt at that point for a moment? In the surrendering of the first lien position you mean to the extent that the Terre Haute bonds and the Northern first mortgage bonds are on a parity over the whole system?

A. No, I would not say that that was the surrendering of it. The surrender of the first lien position is that 40 per cent of their claim is in second lien income bonds, not fully cumulative, with improvement and betterment fund obligatory following the 60 per cent, which is fixed interest. And in addition to that the general mortgage bonds, as outlined in the plan, share their first lien position on the system as a whole with the holders of the loans, with the holders of the mortgages on the Terre Haute and with
2984 the holders of the Milwaukee Northern mortgages.

Q. So the—

A. (Continuing.) But the lien of the new first mortgage extends to the property covered by these mortgages which now share in the first lien, and in addition extends to the property covered by the first and refunding mortgages,

namely, the lines west, or primarily the lines west of Mobridge.

Q. So the principal sacrifices are in this question of lien?

A. I wouldn't say that the principal sacrifices are in this question of lien.

Q. Isn't the—

A. I wouldn't say that these other sacrifices, that these other sacrifices, but not from a practical standpoint measure up fairly close or just exactly what the relative sacrifice is, I would not want to say.

Q. Leaving out the question of lien, what other sacrifices are there?

A. The other sacrifice is that there is an improvement and betterment fund, obligatory, that comes before there is any interest on that part of the claim that is satisfied in income bonds.

Q. That is the $2,500,000 or 50 per cent?

A. Annually.

Q. Annually?

2985 A. Annually.

Q. There was an analogous provision in the 1935 plan, was there not?

A. My recollection of the 1935 plan was that the improvement and betterment fund there was optional to a certain extent.

Q. I think that is correct.

A. Although I am not certain.

Q. That is correct, and there was another difference as well, as I remember it, it came after the other contingent bond but not before.

A. I think it came—I am not certain.

Q. Well, I think that is the difference.

A. There was a difference, as I recollect.

Q. Well, now, may I ask what conversation you had with the Committee which led to injecting into the situation this question of liens which until your plan was filed, so far as we are concerned, had never been mentioned?

A. In the discussions which took place with respect to whether or not a new plan should be brought out by the Committee, the opinions expressed and the discussions which took place were primarily directed with respect to this question as to what were the probable earnings to be expected in the average normal year, and then what, with

those limitations that could be expected, what was
2986 the fair and equitable participation in those limited earnings by these various mortgages.

Q. Well, isn't the annual fixed charge and contingent charge very closely the same under this plan as it would have been under the 1935 plan?

A. That under the 1935 plan, you must remember—

Q. I know, I don't mean to commit you on the subject that way. The 1935 plan, if I remember rightly, had a schedule showing total fixed charges as seven million one as against your total fixed charges in this plan of six million five, but when you went to contingent interest charges, contingent interest charges in the old plan, the 1935 plan, had seven million contingent interest and I think you have considerably more.

A. Our contingent interest charges, if I am correct, are five million, about five million two, five million three.

Q. Oh, I beg your pardon, quite right, I was reading the wrong figure.

A. Now, in addition to that it is my recollection of the 1935 plan, and it may be somewhat hazy, the obligations to the Reconstruction Finance Corporation that were to be satisfied, worked out through this period, and the R. F. C.
in connection with that plan, on the basis of that
2987 reorganization, could be brought about by December 31, 1935, extending open credit to the railroad company for certain purposes. That credit, as I recall it, amounted to about $12,000,000 for equipment, and another $12,000,000 for A's and B's, so that there was that other feature of the plan.

And furthermore, in considering your 1935 plan you should bear in mind that that plan was strictly a stand-by plan so as to determine during this period, which would be not less than five nor more than ten years, what was going to happen to that property. Now, we have come along since 1935 and we have been faced with the situation that we are faced with today, prompt reorganization has not been possible, and so the situation that we are faced with is not what you say would be a proper stand-by plan to see what would happen, but what today is the plan, as we see the picture, that will work out to be a plan with a sound capital structure.

Q. You, I take it, are not familiar with the details, and will reserve that for another witness, the details of

preparing these segregation formulas, allocation formulas, Mr. Oliphant is more familiar than you about it?

A. I take it that is very true.

Mr. Panteleoni: Well, I take it that I have what
2988 I need as a foundation for my motion.

I make this motion, not in any captious spirit at all, it is made with all sincerity. I move that we be granted an adjournment for a period of not less than three months, within which to prepare for cross-examination, to prepare an affirmative case, and to do the necessary that will have to be done before one could possibly collect consents to any plan. We had no knowledge of this plan of the institutional investors until January 10, 1938, and we are just barely out of the month of January now. Now, no one had any idea——

Director Sweet: We will not argue the motion. Will you please reduce it to writing?

Mr. Panteleoni: I shall do that. May I ask of counsel for the Committee, have you any objection to such an adjournment?

Director Sweet: We will take the gentleman's motion in writing, but we will not discuss it further at this time.

Mr. Clay: Mr. Director.

Director Sweet: Proceed, Mr. Clay.

Q. (By Mr. Clay.) Mr. Walker, would you be good enough to turn to Exhibit 181, in the column under the heading "First and Refunding Mortgage" there appears against the line "other income" the figure $402,031,
2989 which is followed by a foot-note (e); could you furnish us a breakdown of that figure, showing what it is composed of?

A. I think that that breakdown is in—the Debtor can give a breakdown of that figure, it being taken as the total income on the collateral that was arrived at by the accounting department of the Debtor.

Q. That was income actually received, was it?

A. Actually paid?

Q. Actually paid?

A. On that collateral. I do not think it was received by the Reconstruction Finance Corporation.

Q. Would there be any objection to your obtaining from the Debtor and supplying for the record a breakdown of that figure?

A. Be very glad to do it, Mr. Clay.

Q. We would—

Mr. Burgess: Mr. Clay, that is in Exhibit 145. Now here it is, you might see if that is correct.

The Witness: I thought it was in an exhibit.

Mr. Marsh: Mr. Director, I want to join, if I could, in the motion made by Mr. Panteleoni, and I want to ask Mr. Walker just two or three preliminary questions as a basis for it.

Director Sweet: Let Mr. Clay conclude his cross-
2990 examination.

Mr. Marsh: I wonder if you want the motion joined in one paper?

Director Sweet: Let Mr. Clay conclude his cross-examination.

Mr. Marsh: Very well.

Director Sweet: We will hear one at a time.

The Witness: Mr. Clay, I believe the breakdown of that figure is shown on Debtor's Exhibit 145.

Mr. Swaine: I am not sure that is correct. We have here the memorandum which was used in 145.

Mr. Clay: Well, apart from that, assuming that it is not set out in detail in Exhibit 145, would you be good enough to furnish it?

Mr. Swaine: Well, I can give it to you, there are very few items.

Mr. Clay: I am not asking you for it.

Mr. Swaine: I know, but he will get it from me.

Mr. Clay: No, I would like to have it direct from the witness as testimony.

Mr. Swaine: I will supply it, if the Examiner will allow me.

Mr. Clay: Will you take the stand?

Mr. Swaine: I will give you the items: Minnesota Eastern Railway stock—

2991 Mr. Clay: I object to it, Mr. Director, unless the witness is sworn and takes the stand.

Director Sweet: Let Mr. Clay conduct his cross-examination.

Mr. Swaine: I tender Mr. Oliphant. There are just six items, and he can state what they are.

Q. (By Mr. Clay.) To resume, Mr. Walker, will you look at Exhibit 173, is there included in the $402,000 figure—

A. I haven't 173, what is that exhibit, please?

Q. This is a list of securities pledged with the first and refunding mortgage trustee.

A. Oh, first and refunding. All right. I now have the exhibit, sir.

Q. Is there included in the $402,000 figure any interest paid on any of the bonds listed in that exhibit other than the Minnesota Eastern Railway Company bonds?

A. I could not say, without examination, although I—I couldn't say definitely without the breakdown, Mr. Clay.

Q. Well, can you tell me, if it will simplify the question, whether there is included in the $402,000 figure any interest on the $1,515,000 of Chicago, Terre Haute & Southeastern Railway Company first and refundings pledged with the first and refunding trustee?

2992 A. If Exhibit 145 is correct, there is included $75,750 of interest on Chicago, Terre Haute & Southeastern bonds.

Q. Being one year's interest on that block of bonds?

A. That is what is shown on this Exhibit 145, sir.

Q. Is there included any interest on the 38,000 Milwaukee Northern Railroad Company first mortgage bonds?

A. I could not say, sir; there is an item here of all other, and whether that includes this item, being $7,000, whether that includes that interest on those bonds—

Q. You can't say whether it includes interest on either of the two blocks of different issues of Milwaukee & Northern?

A. I cannot.

Q. But the statement which you will furnish us will show us the detail?

A. Yes, sir.

Mr. Swaine: I am advised by Mr. Oliphant that it does not.

Mr. Clay: Well, I don't care about that, Mr. Swaine, but I want a detailed breakdown of the figures and I would like to have an opportunity to see it before it is put in.

2993 Mr. Swaine: Here it is right now.

Mr. Clay: I don't want it now. I want the witness to secure it and furnish it and he has very kindly offered to do so.

Q. (By Mr. Clay:) Mr. Walker, I understand that you obtained valuation of these securities pledged with the first and refunding mortgage trustee of some $8,000,000, that was obtained, was it not, merely by capitalizing this $402,000 figure at 5 per cent?

A. That is correct.

Q. Did you consider any other elements of value in those securities, except capitalizing the earnings?

A. That is all.

Q. Turn again to Exhibit 173; it appears therefrom that the first and refunding trustee held, as of January 31 of this year, $789,000 in cash. In obtaining your $8,000,000 figure as the value of these securities, you did not include that $789,000 in cash; am I correct?

A. I did not include that asset, on the basis that the excess of $2,000,000 had been spent in improvements and betterments subject to the first lien of the first and refunding mortgage.

Q. Am I correct that the effective date of your plan is July 1, 1938?

2994 A. June—I think either June 30th or midnight on July 1, 1938.

Q. So that before the effective date, if dividends are continued at the current rate on the pledged Indiana Harbor Belt Railroad Company stock, that $789,000 now held by said trustee will be increased by $151,000 to some $941,000 in cash, will it not?

A. Would you just state, read the question, please?

(Question read.)

A. I would say that was the case.

Q. Adding that $940,000 to $8,000,000 and some $40,000 obtained by capitalizing at 5 per cent the figure of $402,000, I obtain a figure of some $944,000. Turning to Exhibit 172, can you tell me whether that sum last mentioned is not in excess of the total outstanding first and refunding bonds.

The Reporter: Mr. Clay, if you add $940,000 and $8,040,000, the resulting figure is greater than $944,000.

Q. (By Mr. Clay.) Mr. Walker, will you first take the figure of $940,000?

A. Yes, sir.

Q. Then will you capitalize at 5 per cent the $402,000 figure, multiplying it by 20, and tell me what is the sum of the two figures?

2995 A. I get eight million and about 980,000.

Q. Is that not in excess of the total outstanding first and refunding bonds? I refer you to Exhibit 172. To save time, may I point out that Exhibit 172 shows one block of six million of first and refunding bonds, one block of 2,655,000, and a third and final block of 258,000.

A. That is about equal to the—it is slightly in excess.

Q. Adding those sums we get $8,923,000?

A. Yes.
Q. Is that not less?
A. Yes, sir.
Q. Than the other figure?
A. Yes, sir.
Q. Would not this first and refunding mortgage be a pretty good collateral trust if it covered nothing but the present securities?
A. Well, I wouldn't say that because of the fact—
Q. Well—
A. —that this money which was paid in to the trustee was withheld by the trustee and not released.
Q. I mean—
The Witness: And the necessary additions and betterments on the property had to come out of other funds, so that I doubt whether that money in the hands—
2996 Q. Well,—
A. —of the trustee today is free money.
Q. Would it assist you if I framed my question a little differently: Assuming that the lien was confined to the pledged securities and covered nothing else, would not the first and refunding bonds be secured more than 100 per cent?
A. I would say that that would probably be a proper statement.
Q. Is it not true that those pledged securities and covered nothing else, would not the first and refunding bonds be secured more than 100 per cent?
A. I would say that that would probably be a proper statement.
Q. Is it not true that those pledged securities are in the actual possession of the first and refunding trustee?
A. I believe they are.
Q. So that if the first and refunding trustee releases the lien on everything else and just holds a lien on the pledged securities, the first and refunding bonds will be fully and adequately secured, by your own testimony?
A. I would think so.
Q. Now, in your opinion is an allocation of earn-
2997 ings the only factor to be considered in determining the value of the other properties subject to the lien of the first and refunding mortgage?
A. No, I do not think so.
Q. Is it not true that the year 1936 was a bad growing

year in the western territory through which the first and refunding mortgage property runs?

A. Not in the extreme western territory, but it was a bad growing year from Mobridge to the Rocky Mountains, in my opinion.

Q. It was a drought year in Montana, was it not?

A. I would say yes to that question.

Q. Why was 1936 chosen for an application of the earnings formula?

A. That choice of 1936 was made by the Debtor in application of the formula I imagine to take a recent, more recent year and to—

Q. It was just—

A. Revenues in 1936 showed a substantial improvement.

Q. For the system generally?

A. On the system as a whole.

Q. On the system as a whole?

A. As a whole, over the preceding year. But just why that was chosen by the Debtor I am unable to state.

Q. It was just a coincidence that 1936 was chosen, 2998 which was a drought year in the west.

A. I wouldn't say it was a coincidence; I would say that it was a coincidence that it was a drought year in the west. I imagine that the Debtor in taking that year had some reason for taking it.

Q. You have said that there were other factors which properly might be considered in determining the value of the lines west of Mobridge?

A. Yes, sir.

Q. Have you considered what is the value on a scrap basis of the lines west of Mobridge?

A. I have not.

Q. Have you considered what is the value of those lines to some other system?

A. I have not.

Q. Would you be good enough to turn to page 8 of Exhibit—of the plan dated January 24, 1938? I desire to call particular attention to the paragraph reading as follows:

"The Plan is based upon the level of freight and passenger rates, the cost of materials and supplies, scales of wages and pension and unemployment taxes in effect June, 1937. Subsequent increases in wage scales and the cost of materials have not been provided for, it being assumed

by the Committee that they will be compensated and
2999 offset by rate adjustments or otherwise."

Am I correct in assuming from that paragraph that this Plan is based on the situation which existed in June, 1937?

A. With respect to those items mentioned therein.

Q. And that no allowance has been made for any slump in business or increase in wages and expenses since June, 1937?

A. A slump in business I do not think would be a proper item to use, I do not think it would be proper to include that in a plan, because the plan provides for minimum average earnings, which are less than the earnings in 1936. I would say that the expenses, operating expenses in the forecast of operating expenses, in the forecast based upon the volume, or the revenues forecasted are predicated on the costs of material and labor and the taxes that were in effect in June, 1937, and that the revenues were based upon rates then in effect.

Q. Might not the change which has occurred in conditions since June, 1937, have an effect on the probable value of the fixed interest of 4 per cent bonds provided for in the plan?

A. The value of those bonds would naturally be affected by the times fixed interest was covered, and if the
3000 property came out from reorganization at the moment with the coverage of the fixed interest that the present volume of business would show—

Q. (interposing.) What do you think the new fixed interest bonds would sell for if that happened?

A. At the present time?

Q. Yes.

A. At the present time I think with the sentiment that there is with respect to railroad investment and without the opportunity to know what rate adjustments and economies can be made effective, that railroad bonds generally, including these now 4s, would have such a very limited market that I would not want to express an opinion as to what they would sell for in volume as would be required to realize upon a substantial amount of bonds.

Q. In your opinion these 4 per cent bonds would not sell for face, would they?

A. Not under conditions as they exist today.

Q. How long, in your opinion, will it take for these 4

per cent bonds to become sufficiently seasoned to sell at their face, if they ever will?

A. After reorganization, with the rate adjustment, and with the increased economies which I believe are still possible in the railroad business—

3001 Q. You speak of rate adjustment.

A. Yes, sir.

Q. Are you assuming full rate increase?

A. I am not assuming any specific rate increase. I am assuming that the rates will be adjusted in such a way and manner as to best meet the situation with which the railroads are now faced. With those adjustments, and with increased economies of operation, with a return to normal, or reasonable volume of business generally, that with a coverage of interest on the first mortgage bonds of 1½ to 1¾ times, and after that coverage has been maintained for two or three years, or if the coverage is such that investors believe that it will be retained for two or three years, I believe that those bonds at that time would sell for par in volume on the market. I believe the intrinsic worth of those bonds in connection with this system will be worth par at reorganization.

Q. But if I understood you correctly it may not be for several years, if ever, that they will sell on a market basis of face.

A. I would not predict when they will sell in volume in the market at par.

Mr. Clay: That is all I have.

The Witness: Or better.

3002 Q. (By Mr. FitzGibbon.) Mr. Walker, you are familiar with other reorganization matters where liens, various liens on properties have been or proposed to be disturbed?

A. I am, to some extent.

Q. Are you familiar with the fact that in several of those cases segregations and separations and comprehensive revenue studies have been made?

A. I am.

Q. You have availed yourself of those studies in other cases in formulating your plans?

A. The results of those studies have been availed of in formulating the plans.

Q. Would you say that the study upon which the Debtor has prepared its plan was comparable to the studies that have been made in those other cases?

A. I would think that they are fairly comparable, as to results.

Q. But not, in view of what you have previously testified, that you haven't gone into the details of this case and do not know just how the details have been made up, is that not so?

A. I would say that to my own knowledge I do not know whether the details of these estimates are comparable with the extent of details of other studies that have
3003 been made in other cases.

Q. Now do you know, for instance, what the average ton rate is on the lines west as compared with those lines east?

A. I couldn't say offhend.

Q. Do you know whether it is higher than the general system rate?

A. I could not say.

Q. If such a study was made and it was found that the revenue rate on the traffic moving from the western lines on to the east was substantially higher than that on the general system would you think that that was a factor that could be given weight?

A. Oh, yes.

Q. So while your conclusion is that as far as the results are concerned of this study, you think they are comparable, you do not know as to the details?

A. That is correct.

Q. You have stated here that you set up the plan in order to avoid future bankruptcy?

A. I do not know as I stated it in just those words. I think I stated, or I intended to state, that it was the purpose and one of the objectives that was sought in working out this plan to protect against recurrence of bankruptcy in the future?

Q. You wanted to be conservative?

3004 A. Yes, sir.

Q. In other words, you do not look for a default on the new first mortgage unless there is some radical change in the railroad picture?

A. That is correct.

Q. Do you see any way that there could be a default in the new general mortgage before there is a default in the new first mortgage, don't you think that those defaults would come together?

A. Well, no.

Q. What would cause a default, then, under the new general mortgage before there was a default on the first mortgage?

A. I can't see what would cause a default on the new general mortgage before there would be a default on the first mortgage, because of the fact that the interest on the new general mortgage is contingent and the maturity of every one of the bonds is greater than the maturity of the bonds under the first mortgage.

Q. At what stage under the present capital structure of the debtor is the full interest of the 50 year mortgage earned. I am asking an approximate figure from you.

A. What was that question again, please?

Q. At what amount of net available for interest is the 50 year mortgage interest earned under the existing
3005 capital structure of the Debtor?

The Witness: The question again, please.

(Question read: "At what amount of net available for interest is the 50 year mortgage interest earned under the existing capital structure of the Debtor?")

A. On the basis—$14,561,478 would be required to earn interest on equipment obligations, the loans, the leased mortgages, and the liens under the Debtor's mortgage down through the Chicago, Milwaukee & Gary, which would be through the 50 year 5s of 75.

Q. Now, what would be the amount under the plan proposed by the group at which the present holders of the 50 year bonds would receive a 5 per cent return, I refer to page 55, Exhibit C of your plan.

A. Before the 50 year 5s would receive any return the fixed interest, or the interest requirement would be $9,568,000.

Q. No, I mean, Mr. Walker, the amount at which they would receive their full 5 per cent—it is about $18,000,000, isn't it?

A. I will get it in a moment, sir. Somewhat in excess of $18,000,000.

Q. That is a substantial distance that you bring the 50 year bonds from earning their full charges, is it not, that difference of four or five million dollars?

3006 A. That is correct.

Mr. FitzGibbon: Then that completes my cross-examination.

I would like to join the motion made on behalf of Mr.

William Church Osborn, for further opportunity to have the necessary information availed of in this proceeding so that an informed judgment might be made by the Commission and by the representatives of the security holders in getting and reaching a fair and equitable plan of reorganization.

Director Sweet: Is there any further cross-examination?

Q. (By Mr. Freund.) Mr. Walker, I think you said, in response to Mr. Pantaleoni's question that your Committee did not discuss your proposed plan with the trustee of the adjustment mortgage before the plan was put out.

A. I think that is correct.

Q. Is it not true that your Committee, through your counsel, and also informally by word of mouth from me, was requested to give us an opportunity to meet with you and discuss the plan before it was formulated?

A. I think that is correct.

Q. Now, isn't it also true that the adjustment bonds are the lowest in the grade of bonds held by your group?

3007 A. That is correct.

Q. And is it not also true that the holdings of your group of bonds which are ahead of the adjustment bonds are approximately 88 per cent of what you hold?

A. I quite imagine that that calculation is correct.

Q. Between 85 and 95 per cent?

A. Somewhere in that neighborhood.

Q. It is also true, as shown on your Exhibit 176, that the holdings of your group in the adjustment bonds is only 5¾ per cent of the entire issue?

A. That is correct.

Q. Now, with those facts established, do you think that your group is in a position to do full justice to the adjustment bonds?

A. I think so. I think that we can reach our conclusions, as these various several institutional investors must reach them, on the basis of fair and equitable treatment to securities, regardless of the position that we happen to be in at the particular instant.

Q. But would you not be more influenced by doing well for your 88 per cent than by the 10?

A. Not if we followed—

Q. I mean isn't that a matter of good sound sense?

A. No, I do not think so.

Q. From a selfish point of view.

3008 A. I don't think so. These institutional investors, in some situations the individual companies are in the senior position with respect to their holdings, in other situations they are in a junior position. The same principles must of necessity be applied to the situation, whether you are in a junior or a senior position, and I believe that an attempt has been made in good faith, impartially, to follow those principles, which we believe to be sound in determining the fair and equitable treatment as we saw it and as I saw it in this plan of reorganization.

Q. Well, wouldn't you agree that the interest of these bonds might have been helped by a consultation with those whose only interest is with respect to them, would you not have gained a different point of view by consulting with the people who represented those bonds and no others?

Mr. Burgess: I wrote you on January 10th, Mr. Freund, sending you a copy of this plan and saying that we would be very glad to confer with you at your convenience, and I have not heard from you from that day to this.

Mr. Freund: Well, that was after the plan was filed, Mr. Burgess.

Mr. Burgess: Well, I have not heard from you 3009 even yet.

The Witness: I would like to state this, or to make this statement, in view of the fact that the question has been raised as to whether or not we can consider this question in the spirit and actually in fairness and in an attempt at least to arrive at a solution which is fair and equitable: The major interest of the Northwestern Mutual Life Insurance Company, of which I am Vice President, is in the adjustment 5s. We have a larger interest there than we have in all of our other Milwaukee road holdings combined. And in this situation, and in other situations where we are in the junior position we believe and advocate the same principles to be applied in reorganization as when we are in the senior position, and when we are in the senior position we expect to have the same principles applied in that case.

Q. (By Mr. Freund.) Your Committee represents approximately 21 per cent, between 21 and 22 per cent of the combined indebtedness of this company?

A. That is correct.

Q. Is that correct?

A. Yes.

Q. Now, with respect to the voting trust, as I understand it, it is provided that three members of the five
3010 voting trustees be selected, two by your group, one by the Reconstruction Finance Corporation until they are paid off, and then the three by your group, that is correct, is it not?

A. That is the voting trustees?

Q. Yes. That is on page 42 of the Plan.

A. Yes, but as you stated it there were only to be three voting trustees.

Q. No, I mean three of the five.

A. Oh, yes.

Q. You will select, after the Reconstruction Finance Corporation is paid off, you will select three of the five voting trustees, isn't that true?

A. After the Reconstruction Finance Corporation is paid then any vacancies that shall occur among the voting trustees shall be filled by a majority vote of the remaining trustees.

Q. I think it says respecting the two voting trustees selected by the Committee or their successors, they shall designate the successors of such trustees.

A. I guess that is correct, sir.

Q. In other words—

A. The other, the majority, is in the event of a vacancy.

Q. When the Reconstruction Finance Corporation
3011 passes out, the two voting trustees selected by the Committee, or their successors, shall designate the successor of such trustee?

A. Yes.

Q. In other words, you as a group controlling 21 or 22 per cent of the bonds of the railroad, will then be in a position to designate the majority of voting trustees?

A. During the life of the voting trust.

Q. Well, that is for ten years?

A. That is correct.

Q. Now, inasmuch as you have taken the adjustment bonds out of the secured position and put them all the way down into the common stock, I believe that you admit the desirability of continuity of management by means of voting trust, wouldn't it be fair to give to the holders of this new common stock as recompense for their sacrifices the control of the property?

A. Well, there may be some justification for that argument. On the other hand, my feeling is this: That the

senior lien holders in this situation and particularly the institutional investors which represent there again continuity as to continuing to hold the securities, and being investors in the situation, representing also, as I view
3012 it, organizations that are not interested in arbitrage or profits from the purchase or sale of the securities, but are investing to hold to maturity and have now in recent years through the experience which has shown it to be necessary organizations which can follow the operations of the property, and therefore, in my opinion, it is not improper and it is probably in the interests of investors generally that a voting trust organized in this manner is provided. It may well be that the Commission may differ, and if the Commission differs as to that, why that of course is a question to which we will bow.

Q. But you get your continuity, do you not, by means of the ten year voting trust?

A. We get continuity by means of the ten year voting trust?

Q. Yes.

A. That is quite true.

Q. Yes.

A. But as I am trying to say, when you get your continuity by means of ten year voting trust, the appointment of these voting trustees or the names to be suggested by these voting trustees and the candidates for voting trustees come from institutions or the collective action of institutions whose interest in the property is in the nature of a continuing investment.

3013 Q. Haven't you just stated to me in answer to a previous question that your own company was a very large holder of these adjustment bonds and that some of the others were too?

A. I didn't say some of the others.

Q. No, you didn't say so, but it is a fact that there are other institutions that hold adjustment bonds?

A. That hold adjustment bonds, yes.

Q. Yes.

A. We don't hold all these adjustment bonds.

Q. I did not mean to indicate that you did. There seems to be 95 per cent of them out elsewhere.

A. I mean we don't hold all of the adjustment bonds that are shown on Exhibit 176 at the present time.

Q. Nevertheless you would have the benefit of the advice

of the institutional holders in the selection even if it were given to the common stock?

A. There isn't any question about that, and at the present time I am uninformed as to there being any large representation of adjustment bondholders who are participating here and sharing with institutional investors the burden of these hearings and the reorganization.

Q. Well, the trustee is doing the best it can.

A. But the trustee, as I understand it, will not take the position that under the trust agreement the trustee
3014 is obligated to prepare a plan and that the trustee is obligated to go to the expense of preparing a plan under the trust agreement, that that is not one of the duties imposed by the trust agreement. If it were we would be very glad to impose it on you.

Q. Well, would you advocate in a case of this kind where there are seven or eight trustees under mortgages, that each one should prepare a plan?

A. No, I do not.

Q. Well, then, what is the point of the argument?

A. It is not an argument, it is a statement of the fact that as I understand it the trustee under the mortgage is not an agent of the bondholders and we have had no, there is not in this proceeding any large representation of the holders of adjustment mortgage bonds. That is my understanding of the situation.

Q. Now, you also stated that the general mortgage bonds in addition to being given 100 per cent of mortgage security, divided between two mortgages, was given a share of stock to make up for their sacrifices. Now,—

A. For each thousand dollars of bonds.

Q. Yes. Now seeing that they have been taken care of to that extent, do they also need to be given the control of the voting trust?

A. I think so.

3015 Q. And you think that is perfectly fair to the adjustment bonds?

A. I think so.

Q. Well, now, what have you done for the adjustment bonds to make up for their sacrifice?

A. Unfortunately, there is nothing left for the adjustment bonds that can be given to them to make up for their sacrifices. The question is, and what has been given to them is all that is left when you get down to their junior position.

Q. Well, now, the 5s of 75 you gave a little bit of the same security that was given to the general mortgage.

A. That is correct.

Q. An interest in that. Now why shouldn't the adjustment mortgage as to some percentage, I won't say as to what, but as to some percentage of their claim be put in with the 5s of 75?

A. Because they are wholly junior.

Q. Well, of course, and so are the 5s of 75 wholly junior to the general mortgage.

A. They may be, but they are not wholly junior to the general mortgage with respect to the lien on the western lines. The general mortgage has no lien on the western lines, the situation is not at all analogous.

3016 Q. Well, they have a second lien on the western lines?

A. Yes, but I say they are junior to the 5s of 75.

Mr. Freund: If your Honor please, I will not cross-examine Mr. Walker any more at this time, but I would like to join in the motion, in the written motion for the adjournment, as we have not had any time, any sufficient time since this Plan was filed to take into consideration a situation wholly different from that which existed before it was filed.

Director Sweet: Did you get a Plan on or about the 10th of January?

Mr. Freund: Yes, sir.

Mr. Marsh: May I ask a few questions, if the Examiner please?

Director Sweet: Proceed.

Q. (By Mr. Marsh.) Mr. Walker, the Debtor's plan of July 1, 1935, provided, did it not, that the two Milwaukee Northern issues should remain undisturbed as to lien and interest, and be extended as to principal for ten years, that is until 1939, and certain defaults to be waived, is that your recollection?

A. That is my recollection, and I would like to correct a statement which I made from recollection then, that no liens were disturbed; the adjustment bonds were given preferred stock.

3017 Q. Yes.

A. In the 1935 Plan, and the priorities were not disturbed. They were preserved.

Q. Do you remember what the principal default was that was to be waived?

A. On the Milwaukee Northern?

Q. On the Milwaukee Northern.

A. I do not. I think the principal default—I couldn't say, positively.

Q. Was it not a supposed deficiency of equipments of about $3,000,000?

A. I was just going to say and my recollection was that there was some question under the mortgages as to whether or not there was any deficiency in equipment replacements.

Q. I believe Mr. Oliphant testified that there were only something like ten cabooses, and a few items of that kind at the present time.

A. I understand, but I understand that there was a question as to whether under the provisions of those mortgages the equipment replacement was required.

Q. Yes. Then under the plan filed by your Committee, as amended on January 24, 1938, both of those mortgages are to be replaced, are they not, that is, the bonds are to be refunded in new securities, the first mort-
3018 gage, first mortgage Milwaukee & Northern Bonds receiving 100 per cent in new first mortgage fixed interest bonds, and the consolidated bonds of the Milwaukee & Northern receive 60 per cent in new first, 40 per cent in new general mortgage income bonds of Series A, and one share of stock for each thousand dollar bond?

A. That is correct.

Q. Is there any question in your mind that the new securities are less desirable as an investment than the present Milwaukee & Northern securities?

A. My own reaction would be that I would prefer a first mortgage lien on the entire system rather than on a division.

Q. The facts, as far as they appear on the record up to date, however, indicate that the Milwaukee & Northern interest has been earned, taking both the first lien and the second lien, collectively?

A. That is correct.

Q. And that interest has been paid, has it not, under Court order up to and including December 1, 1937?

A. That is true.

Q. And those bonds have commanded a very fair market, have they not, during the course of the proceeding?

A. I could not state as to that.

Q. I wonder whether you could tell us or explain
3019 what the difference was in the holdings of your Committee of that issue between the figures stated in

the plan and the figures stated in the exhibit; the exhibit, I believe, gives the holdings as of December 31, 1937.

A. Yes, sir.

Q. And that shows 877,000 of the Milwaukee Northern first 4½s, whereas the holdings at the—as indicated on page 2 of the Plan, are $1,506,000 and that is as of the date of commencement of the proceeding.

A. That was, yes, substantially shortly after the date of the commencement of the proceedings.

Q. So that the institutions have sold some of the bonds?

A. Well, I wouldn't want to say that. I would have to determine that fact, because there were some holdings that were originally included in the list which upon investigation it was found that they were not,—they were held in trust.

Q. Oh, I see.

A. And were not the bonds of bona fide holders. Whether that accounts for the difference or not I am unable to state at this time.

Q. Then there is a difference the other way in the Milwaukee Northern consolidated bonds?

3020 A. Yes.

Q. The plan, at page 2, showing $385,000, and Exhibit 176, $602,000.

A. Yes.

Q. There the holdings apparently have increased by at least the amount represented by the two.

A. There is that apparent increase.

Q. And it had occurred to me that it might indicate that the consolidated bonds appeared valuable to the members of your Committee, sufficiently valuable to buy some of them. Now, has your Committee had any communication with the representatives of the holders of Milwaukee Northern bondholders since the September hearing or with the Milwaukee trustee?

A. I think there was a communication with the Milwaukee trustee, or communication from the Milwaukee trustee.

Q. Well, it was suggested that the Milwaukee trustee would be glad to discuss the provisions of the Plan with the Committee, was it not?

A. I think that was a matter of the communication.

Q. And then after the Plan was filed communication was sent, was it not, requesting details as to the basis

upon which the, or the facts upon which the changed
3021 position for the Milwaukee Northern bonds was suggested?

A. That is correct.

Q. And the reply to that was, of course, that the exhibits had not been completed?

A. That is correct.

Q. I understand that they were not completed until a day or two before this hearing, as I understand?

A. That is correct.

Q. So that there was no opportunity for the Milwaukee trustee at least to discuss the provisions of the Plan as to the Milwaukee Northern bonds until practically we got here in the court room?

A. That is correct.

Mr. Marsh: I think that is all, your Honor, that I wish to bring out at this time in connection with our motion for an adjournment to permit further study of the evidence and to permit us to prepare additional evidence.

Director Sweet: You have completed your cross-examination?

Mr. Marsh: No, sir, I have not; but I cannot cross-examine with adequate intelligence until I know more about the facts. I have certain questions that I could ask, but they will largely be guess-work questions.

3022 Director Sweet: Well, you use your own judgment as to whether you ask them now.

Mr. Marsh: I prefer to defer it.

Director Sweet: If you have completed your cross-examination, let somebody else ask the questions.

Mr. Marsh: Do I understand that I am through if I do not ask them now?

Director Sweet: I am not saying.

Mr. Marsh: Well, I will go ahead and ask them.

Mr. Panteleoni: I am in the same position. I prefaced my questions by stating that I was laying a foundation for my motion for a continuance.

Director Sweet: You have made your request for an adjourned hearing, and whether you get it or not has not been determined.

Mr. Panteleoni: But if I do not get it, I waive cross-examination.

Director Sweet: If you do not get a further hearing I guess you are through.

Mr. Panteleoni: Well, that is most distressing news.

Mr. Marsh: I should like to go ahead, then.

Mr. Panteleoni: Well, you go right ahead, and I will follow you, then.

Mr. Marsh: I should like to supply for the 3023 record two lists of the series of petitions and orders in the court case relating to the intervention City Bank Farmers Trust Company, as trustee under the two Milwaukee Northern mortgages, and then relating to the payment of interest on the bonds.

Director Sweet: The proceedings in court have been filed.

Mr. Marsh: Is that formally a part of the record?

Director Sweet: With this Commission, and they are considered to be a part of the record in the case.

Mr. Marsh: Well, then there is no occasion to do that.

Q. (By Mr. Marsh.) On page 9 of your Committee Plan, Mr. Walker, there is a column headed "Interest Accruals on Principal Only (for 12 months ending June 30, 1939)." That is the last column, and the next to the last column is entitled, or the second column is entitled "Interest accrued and unpaid June 30, 1938."

A. Yes, sir.

Q. Now, under Milwaukee Northern Railroad first mortgage there is no figure in the first column but there is the whole year's interest in the column for the year ended June 30, 1939, and under the Milwaukee & Northern consolidated mortgage there appears an item of one-half year's interest under the column for June 30, 1938, and a 3024 whole year's, almost a whole year's interest in the 12 months ending June 30, 1939. Does that indicate anything which has occurred that interest has been paid up to date?

A. It has been paid up to date, but the proper reservations have been made in connection with the payment of that interest, so that the question of continuation of the payment of interest on the consolidated mortgage bonds—

Q. On the consolidated bonds of the—

A. On the consolidated mortgage bonds can be properly opposed in the court as to the payment of further interest.

Q. Yes.

A. Prior to the consummation of the plan.

Q. Well, this last column on page 9, however, does not indicate that.

A. No.

Q. Interest is to be paid in 1939, I mean that the Committee has computed it.

A: The last column merely shows not interest that is to be paid, but it shows the interest accruals on principal only.

Q. Yes.

A. That for the 12 months ending June 30th, 1939, which is the first full year.

3025 Q. Yes.

A. After the assumed date of the consummation of the Plan.

Q. Oh, I see.

A. Would run, and that has nothing to do with whether or not, is no indication of whether or not the interest will be paid.

Q. Yes, I see. Now returning to the per cent of new securities to be issued under the Committee Plan in place of the present Milwaukee & Northern securities, have you considered the relative coverage in par value between the present Milwaukee & Northern first mortgage bonds and the new first mortgage bonds to be issued under your plan?

A. That was considered. It appears in the elements of value by mortgage districts.

Q. Yes. I found Exhibit 76 indicates that the elements of value for Milwaukee & Northern are $12,755,608.

A. Yes.

Q. But I did not know that the elements of value for the new first mortgage district had been given in the evidence.

A. Yes.

Q. That is, the property which would be subject to
3026 the new first mortgage so that you could make a comparison of the relative dollar for dollar coverage in each per bond. Possibly it will be easier for Mr. Walker to supply that later, at the close of the day.

A. All right, sir.

Q. Would that be agreeable?

A. I think I will be able to supply that. I am not certain whether I can or not, from the papers that I have with me here.

Director Sweet: Can you bring the answer tomorrow, sir?

The Witness: I will endeavor to do so, sir.

Director Sweet: Any other questions?

Mr. Marsh: Yes, surely.

Q. (By Mr. Marsh.) We will then pass from the matter of comparative property coverage, which in the case of the

Milwaukee & Northern issues is about 12 to 7, according to Exhibit 76, and have you made a comparison of the relative interest coverage as between the new first mortgage bonds of your Plan and the first mortgage bonds and the consolidated bonds of the Milwaukee & Northern?

A. I have made and determined what I believe to be—that is, from the estimates of the Debtor, what the interest coverage is on the first mortgage bonds of the Milwaukee & Northern.

3027 Q. You stated a figure of something in the neighborhood of four times interest on the Milwaukee Northern first mortgage bonds, I believe, in your testimony yesterday, of four times interest.

A. It is my recollection that that is approximately correct.

Q. But you did not give a figure for the consolidated.

A. Yes, I gave a figure for the consolidateds, after stating the various items which I felt should be given consideration in view of the fact that the formula that was used in allocating the earnings to the Milwaukee & Northern was virtually on a foreign road basis, or partly on a foreign road basis and partly on a system basis, and that, as I view it, if the general mortgage was given credit for the traffic to and from the Milwaukee & Northern—

Q. Yes.

A. That terminated or originated in the Milwaukee terminals, under the general mortgage.

Q. Yes.

A. Or passing through the terminals to or from foreign lines at Milwaukee and then over the Milwaukee & Northern, if the general mortgage was given consideration for those terminals other than the manner in which they have been treated, namely, the Milwaukee & Northern were

3028 given the full tariffs—

Q. But charged a switching charge.

A. While on the Milwaukee, a switching charge, and if their facilities, used and useful in connection with the Milwaukee & Northern, in which the general mortgage had a substantial investment were charged against them, and if the general mortgage didn't carry the surplus equipment investment necessary to take care of peak loads, looking at the situation and after going into the matter I felt the coverage of interest on the consolidated mortgage bonds would be substantially the same as the coverage shown for general mortgage bonds.

Q. That is 1.16 times earnings?
A. 1.16?
Q. Yes.
A. Without any of these credits coming to the general mortgage or being reflected in the general mortgage earnings.
Q. That is the per cent indicated on Exhibits 180 and 182?
A. That is correct.
Director Sweet: We will be in recess now until 9:30 tomorrow morning.

(Whereupon, at 4:35 o'clock p. m., an adjournment was taken to 9:30 o'clock a. m. of Thursday, February 3, 1938.)

3030 BEFORE THE

INTERSTATE COMMERCE COMMISSION.

Hearing Room C,
I. C. C. Building,
Washington, D. C.,
Thursday, February 3, 1938.

The hearing was resumed, pursuant to adjournment, at 9:30 o'clock, a. m.

Before:

Director O. E. Sweet, and Examiner M. S. Jameson.

Appearances:

The same as heretofore noted.

3033 Proceedings.

Director Sweet: Proceed, Mr. Marsh.

FREDERICK W. WALKER testified further as follows:

Cross-Examination (Continued.)

Q. (By Mr. Marsh.) Shortly before we adjourned yesterday, Mr. Walker, you stated that you would be able to prepare a comparison of the property coverage or return interest coverage of the Milwaukee & Northern Lines with

the interest coverage of the new first mortgage under our plan.

A. Well, that was not as I understood it.

Q. Wasn't that the question?

A. In my statement and previous testimony I did compare the coverage on the basis of the modifications and adjustments that I believe should be made to the formula.

Q. Yes. You compared that and stated, as I remember it, that the coverage of the new first mortgage was the same, approximately, as that of the general mortgage?

A. That is correct. As I understood your request, you asked if I could separate the elements of value.

Q. Yes, that is true. That was the question.

A. The elements of value between the first mort-
3034 gage and the consolidated mortgage of the Milwaukee & Northern, and compare those elements of value compared to the outstanding bonds with the elements of value for the new first mortgage bonds of the system.

Q. Yes; that was the question.

A. And in connection with that I referred to the report of the Interstate Commerce Commission Valuation Bureau and have prepared with respect to the Milwaukee & Northern a distribution of those elements of physical value, of which I made copies to the extent that it was practical to make copies last evening.

Mr. Burgess: Can this be given an exhibit number?

Director Sweet: Exhibit 186.

Mr. Marsh: I will offer that as an exhibit, representing Mr. Walker's computation in the position in which we find ourselves.

Of course, I have had no opportunity to compare this with the valuation report or to check it in any other way. I am very much obliged, Mr. Walker, for making the computation.

(The document above referred to was marked "EXHIBIT NO. 186, Witness Walker," and was received in evidence.)

Mr. Burgess: Is there anything else that you had made up, Mr. Walker? There were two or three other requests.

I think you might just as well put them in now while
3035 we are doing it, unless it interrupts your examination.

Mr. Marsh: No; I would like to.

Mr. Burgess: What else have you?

The Witness: I also made a similar computation with re-

spect to the elements of value as of December 31, 1935, of the property owned for the Chicago, Milwaukee, St. Paul & Pacific Railroad Company, and the Chicago, Terre Haute & Southeastern Railway Company based upon consolidation of the Terre Haute with the Milwaukee road as provided in the plan.

Mr. Marsh: This would be the property back of the new first mortgage?

The Witness: The first mortgage.

Mr. Burgess: Well, it is not property; simply the elements of physical value, is it not?

The Witness: Yes.

Mr. Burgess: May that be received as Exhibit 187?

Director Sweet: Yes.

(The document above referred to was marked "EXHIBIT NO. 187, Witness Walker," and was received in evidence.)

Mr. Burgess: Now, did you have something else that you were going to furnish in response to Mr. Clay's request?

3036 The Witness: Mr. Clay requested a break-down of the item which was shown in the estimated earnings of the first and refunding mortgage district, the item being the item of other income, and amounting to $402,031.

The Debtor made available to us last evening the figures which constitute that break-down, and we therefore have drawn up that statement and believe it to be correct.

Mr. Burgess: May that be received as Exhibit No. 188?

Director Sweet: Yes.

(The document above referred to was marked "EXHIBIT NO. 188, Witness Walker," and was received in evidence.)

Mr. Burgess: That is all of the information that you had prepared in statistical form in answer to the request made yesterday, was it not, Mr. Walker?

The Witness: That is correct.

Mr. Burgess: All right, Mr. Walker. Thank you.

Mr. Marsh: Thank you very much, Mr. Walker.

Director Sweet: If you have occasion to make more copies, will you furnish us with another one later?

The Witness: Yes, sir. I think I can furnish another copy now.

3037 Director Sweet: Very well.

The Witness: I do have one more set.

Director Sweet: Thank you.

Q. (By Mr. Marsh.) Now, in this Exhibit 186 which you have just introduced, entitled "Elements of Value as of December 31, 1935, of Property Underlying Mortgages," comparing the Milwaukee & Northern mortgage debt with the elements of value of the property under the two mortgages, you have not included any valuation for equipment —or, to put it in another way, the valuation report does not include any value for equipment, so far as you know?

A. I believe it does for the equipment that was in existence as of December 31, 1935.

Q. That is the twenty cabooses and other small items that were referred to in Mr. Oliphant's testimony?

A. Whatever equipment was then in existence and was by the Debtor identified as being subject to the lien of the Milwaukee & Northern mortgage, yes.

Q. Well, if the question as to whether the mortgages required the mortgaged properties of the Milwaukee & Northern to be fully supplied with the equipment—or, the equipment fully maintained, there would be an additional item there of some $3,000,000, would there not, which should be added if that covenant had been complied 3038 with?

A. Oh, if the covenant had been complied with and the equipment was there—

Q. Yes, the two "ifs".

A. —then to the extent that there was equipment there, these values would be increased.

Q. Well, in your testimony yesterday with reference to the reasons which led you to recommend the treatment given to the Terre Haute issues, you referred to the fact that covenants which had not been complied with of the same character in the Terre Haute mortgages and the vacancies of some $7,000,000.

Now, there would be the same equity if those two "ifs" are in favor of the Milwaukee & Northern?

A. I did not say that there was an equity for the Terre Haute to the extent of $7,000,000. I said there was a deficiency—

Q. Yes.

A. —in replacement of equity to the extent of $7,000,000.

Q. But that was based or predicated on the assump-

tion that the covenants did require that much more in valuation of equipment?

A. That is true.

Q. If the situation is the same here and the con-
3039 struction of the covenants should be the same as in the case of the Terre Haute bonds, you would not have a similar item to your $7,000,000?

A. We would have a similar item of default.

Q. Of default?

A. Under the mortgage.

Q. That is what I mean.

A. Of default.

Q. Which would create an equity of the same but not greater strength than the equity which you referred to in favor of the Terre Haute bonds?

A. Yes. I think all defaults by the Debtor under equipment would probably stand on substantially the same basis.

Q. Well, that could, at best, be only general creditors' claims.

A. That would be my interpretation of it, although that is a matter of law.

Q. That is a matter of law, which I have not had an opportunity to investigate.

Have you considered in connection with the provision recommended for the Milwaukee & Northern issues the valuation of the Milwaukee & Northern properties looked at as an independent line as distinguished from their operation as a part of the System?

3040 A. I have looked at that from that angle, but not on the basis of a calculation as to just what the Milwaukee & Northern Lines could possibly do as independent lines.

Q. Yes.

A. I have discussed that matter with representatives of the Debtor but no detailed calculation was made in connection with it.

Q. That is, there has been no severance study or contributive traffic study of the character that there have been, say, in the North Western Case?

A. I would say no: not to my knowledge, to the extent that there was in the North Western Case, but I believe that officers of the company thoroughly familiar with the

situation have given sufficient consideration to express that question so that it is entitled to be classed as a study.

Mr. Marsh: That is the type of information, Your Honor, that we would like to consider before having the door closed on our case.

Q. Have you considered at all the classification or the comparative classification of the Milwaukee Northern bonds with the classification of the general mortgage bonds as rated by Poor's Manual or other corresponding manuals?

3041 A. I cannot say that I have specifically.

Q. Would you consider that that had any bearing on the treatment which should be accorded to the three classes of bonds in your plan?

A. I would not give very great weight to that classification in considering the treatment to be accorded to the bonds.

Q. Have you given any consideration to the relative market values of those bonds both before and during the pending proceeding?

A. I have not given consideration to market values.

Mr. Marsh: I have a tabulation here which I should like to offer in evidence showing for the Milwaukee & Northern first mortgage 4½'s, for the Milwaukee & Northern consolidated 4½'s and the St. Paul general mortgage 4½'s the Poor's Manual rating and the Poor's Manual high and low price for each year from 1931 to 1937, inclusive.

I have not copies at all. I should like to offer that in evidence and supply copies later.

Director Sweet: You had better wait until you have copies and then submit them, and if there is objection, you will have to prove it.

Mr. Marsh: Well, there is no mystery about the figures. They are taken right out of Poor's. Of course, they

3042 would be subject to correction; if there is any mistake, it can be corrected.

Director Sweet: When you have sufficient copies that will be considered.

The Witness: I would like to say in connection with the market quotations that I did not give consideration to specific quotations during this period.

Q. (By Mr. Marsh.) That would be affected by the action taken on the interest bonds, I assume?

A. That would be affected by many factors.

Q. Have you had occasion in recommending the provision to be made for these two issues to make a comparison of the Milwaukee & Northern's property with the Terre Haute property, in point of value of their contribution to the system and their possibilities of operation as independent roads?

A. A Debtor's exhibit shows an estimate of contribution to the system of the Milwaukee & Northern and other estimates of what the Terre Haute has and does contribute to the system at the present time.

Q. Those are the figures which appear at the bottom of Exhibits 141, 142, for instance, and 145?

A. Yes. And, I have given consideration to those figures as I have previously testified to.

Q. Do those figures lead you to believe that all
3043 of the Terre Haute issues are superior in strength to the Milwaukee & Northern consolidated?

A. They do as at the present time.

Q. Has your committee considered the possibility of the Milwaukee & Northern being supplied with coal from the lake district to the north, as compared to the Terre Haute Lines' source of supply?

A. It has.

Q. What conclusion did you arrive at?

A. The conclusion arrived at was that there would be a slight additional cost to the Milwaukee & Northern based on the purchase of lake coal, and after giving credit to the Milwaukee & Northern for the increased B.T.U. value of that coal.

Q. And deducting or crediting the difference in the haul, the road haul cost?

A. Yes, sir.

Q. So that you felt that that would not help the Milwaukee & Northern?

A. I felt that it would be somewhat the other way.

Q. Somewhat against its interest to change?

A. Yes, sir.

Q. Does your committee feel that this charge for system equipment which was referred to in Mr. Oliphant's testimony and exhibits of five per cent of the depre-
3044 ciated reproduction cost new is a considerable charge?

A. That is as low a charge between system roads, between Milwaukee divisions, as might properly be made

for rent of equipment, but this charge as applied does not take into consideration the necessity for the owner road carrying the excess or maximum amount of motive power and equipment that is required to handle the traffic during peak periods.

Q. That is stand-by equipment?

A. That is really in effect stand-by equipment. That again, I feel, in connection with the Milwaukee & Northern would make some adjustment downward in the income available for interest.

Q. Has that any precedents in any of these other more active cases, like the North Western Case; a charge of this character between divisions?

A. I am not able to state exactly what the charge between divisions is on the North Western Case. The final reports of Coverdale & Colpitts, making that study, have not as yet been turned in, but it is my viewpoint that this 5 per cent on the depreciated value less salvage is a reasonable charge; but a minimum.

Q. Its fairness would depend to some extent on the age of the equipment, would it not?

A. Well, that is taken care of.

3045 Q. By the depreciation?

A. By the depreciation, because the 5 per cent being figured on depreciated value, it might show up that the equipment had no value, if it was old enough, upon which the 5 per cent was applied, and yet for certain periods of time, and under certain conditions, was brought into temporary use.

Q. But, on the equipment acquired, for instance, during the trusteeship, it would be relatively high, the charge, would it not, where there had been practically no write-off at all?

A. It would not be a relatively high charge, because there is new equipment purchased, because of the necessity for new equipment, and also for another reason, of either the increased economies of operation from that equipment, or else the additional traffic which flows from the use of that equipment or that by reason of that equipment the inroads into the traffic for which it is used are checked.

Q. The 5 per cent on new units of equipment would be higher than the interest paid on the equipment trust obligations of the Trustee, probably?

A. Under the conditions in the money market upon

which the Trustees' equipment trusts were sold, it would be higher, yes, in this instance.

3046 Q. But you do not know, I presume, what part of that new equipment is in use on the Milwaukee & Northern Line?

A. I do not.

Q. I do not either. In making the computation in the schedule attached to the plan showing coverage in different issues—rather, on these exhibits you introduced, I think it was Exhibit 156—did you include or exclude the $58,000 of Milwaukee & Northern bonds which are pledged under the first and refunding mortgage, do you remember?

A. Which exhibit would that be?

Q. Exhibit 156, I think it was, where you separated the earnings of the different lines; in the first column there near the bottom, interest on Milwaukee & Northern bonds outstanding, $323,505.

A. I would have to check that to be in a position to testify whether the pledged bonds were included.

Q. I wonder if that could be supplied later in the hearing?

Mr. Swaine: We are advised that it is not included.

Q. (By Mr. Marsh.) Now, referring to Exhibit 181, you divided there for the purposes of comparison of different mortgage districts, the net income derived from

3047 the actual earnings of 1936, as I understand it, $109,142,068?

A. That is correct.

Q. In the table Exhibit C annexed to your plan, you computed the results of the new securities, of the estimated earnings of the normal year, of $126,900,000, do you not?

A. That is correct.

Q. Well, if those gross revenues of a normal year were to be realized, there would be no possible question that the Milwaukee & Northern Lines would receive better revenues, both gross and net, than appear in the figures for 1936?

A. I think that is true.

Q. And the interest on not only the first mortgage, but the consolidated mortgage of the Milwaukee Northern would be amply covered by earnings?

A. Yes, I think the same relationship would probably exist.

Q. Yes.

A. —between the Milwaukee & Northern earnings, if

the revenues were larger, or approximately the same. You cannot say that it would be actually the same relationship, because conditions might affect that, but with an increase of the gross of the system from $109,000,000 as shown
3048 on Exhibit 181 in 1936 to $126,095,000, on the same basis of rates upon which Exhibit 181 is set, I believe that each of the mortgage districts would show larger revenues,—

Q. Yes.

A. —and which was income available for interest, thus showing a greater coverage than was shown on this exhibit.

Mr. Marsh: I see. That is all the questions that I have prepared to ask of Mr. Walker, but I feel if I know more about it I should like to ask him further questions if I have an opportunity to study the matter.

Q. (By Mr. Pantaleoni.) Mr. Walker, referring to Exhibit 181, the Terre Haute column, has any account been taken in that column of the deficiency in equipment under the lease?

A. There has not.

Q. In other words, the system, is charged by this equipment, for the use of this equipment, in the same manner that it has charged the other segments?

A. I think that is true. I think under one equipment trust that was assigned to the Terre Haute, and that that part of the system was treated as though owned by the Terre Haute.

3049 Q. But the $7,000,000 is in addition to that?

A. That is correct.

Q. Now, if I remember correctly the Terre Haute allotment of earnings showed a net credit of $2,209,000 before your committee reviewed it; am I right or wrong?

A. I don't know whether I could say before our Committee reviewed it or not.

Q. Well, as the exhibit was originally filed.

A. The exhibit as originally filed—I think that was No. 139, or whatever the number was—showed $2,990,000.

Q. $3,000,000?

A. $2,990,126, as I recollect it.

Q. That was the figure I had in mind.

Now, after your readjustment it shows $875,000?

A. I would say after the Debtor's readjustment. These readjustments were made, as shown on Exhibit 181, by the

Debtor to bring the operation around to substantially the system basis.

Mr. Swaine: In order that this record may be clear Mr. Walker, when you say "made by the Debtor" you mean the computation was made by the Debtor on your request upon the hypothesis stated by you?

A. Possibly that is the correct way to state it. I would say it was made by the Debtor after conferences
3050 with representatives of the Debtor in which it developed in those conferences that it would be a desirable thing if we had these adjustments to show what would be the situation on a system basis.

If I made the direct request, which may have been the case, I have no objection to the record so showing, but in any event it was made as the result of conferences with representatives of the Debtor on the basis that it was a desirable thing and necessary information to have.

Q. (By Mr. Pantaleoni.) Well, in answer to a previous question of mine I understood you to say that the Committee approved of the policy or the principle underlying that change.

A. Oh, yes.

Q. And that you are not submitting for the Debtor.

A. No.

Q. You are submitting for the Committee.

A. That is, for myself.

Q. Oh, yes; but when I say "you" I mean you personally and the committee.

Now, you also testified that no credit was given to the lines covered by the first and refunding mortgage, for that adjusted equity in earnings for the Terre Haute?

3051 A. I did so testify and I stated that the adjusted earnings for the Terre Haute in the light of the character of the road and in the light of the necessity for those earnings continuing, the necessity of the continuation of the purchase of the company's coal from mines on the line of the Terre Haute, that that amount of net income after payment of interest was a matter or an item that seemed to me was not something that was funded; possibly that might not be funded.

Q. But that net increment remaining would, under the pledge, accrue to the first and refunding lines, would it not?

A. That is true.

Q. And if that had been credited it would ge a long way to wipe out the deficit that I see of $1,071,000.

A. Well, but that deficit of $1,071,000 was a deficit accruing in only one year. In addition to that, against the first and refunding lines, there was the expenditure necessary for the continued operation of the line to properly serve the public of somewhat over $2,000,000 out of the Trustee's, or the bankruptcy Trustee's funds on improvements and betterments on the first and refunding lines.

Q. I see.

3052 A. When it comes to a final accounting, it would seem to me some consideration must be given to those expenditures.

Q. Well, just parenthetically, I thought I remembered your offsetting that $2,000,000 item against the cash now held, to the extent of that cash, at least.

A. To a certain extent of that cash, but the amount of that cash—

Q. Is $800,000, isn't it?

A. About $800,000.

Q. So that leaves $102,000.

A. Yes. But, I think when you came to actually—if such a thing is done, to actually go into the improvements and betterments put on the first and refunding lines that you will find the amount was substantially in excess of $2,500,000, but if it is examined, in reaching the conclusion with respect to the treatment to be accorded to those securities, that we are relying upon the relative value of the first and refunding lines.

After I felt confident that there was at least $2,000,000 spent on improvements and betterments, so that I believe I could confidently make that statement that it had been done, I did not see the necessity of going any further.

3053 Q. Now, the improvements and betterments that you refer to are included as expenses, aren't they; that is, you don't capitalize them, do you?

A. Oh, these are capital expenditures.

Q. Yes, but in arriving at the deficit of $1,071,000, has that $2,000,000 not been taken into account pro rata for that year?

A. No, it has not.

Q. I should think when you were preparing an estimate of the earning capacity of the road, that one would not lay too much stress on the capital investment made in that

road; one would say: what does it earn, which would be the $1,071,000 deficit.

A. Plus what must be spent to keep it earning, otherwise it would not earn.

Q. That $2,000,000 was over what period?

A. The period of the bankruptcy, since June 30, 1936.

Q. If I remember rightly, during that same period there was $12,000,000 spent on maintenance on the lines east?

A. That is correct, or thereabouts, as I recollect the figure.

Q. Not maintenance—I am sorry, repair of roads; improvements and betterments.

A. Capital expenditures.

Q. You traveled over the western lines?

A. I did.

3054 Q. Is the line in good repair?

A. It was in excellent repair, in my opinion.

Q. What is the mileage of the so-called western line west of Mobridge, approximately?

A. I would not be able to give you that off-hand. The record would show.

Q. It is approximately, or over 3000 miles, isn't it? Well, never mind.

A. I would not want to say from memory, sir.

Q. Now, you were asked a moment ago some questions with regard to the normal year and I should like to ask whether it is not true that the total capitalization which you propose is based primarily on what you have endeavored to show would be in your opinion the normal year?

A. That is a very controlling factor in determining capitalization.

Q. And yet in making the allocation of that capital you did not attempt to take a normal year but took, roughly, a single year 1936?

A. We took the year 1936 upon which the Debtor had made a study and made an allocation.

If we went to the normal, so-called forecasted year, to make an allocation, we would then have to go into all of the various assumptions as to when that year might
3055 be and as to how the traffic during that year was actually distributed and routed and its character.

Therefore, with this study available as to what was and is approximately the situation now, that appealed to me

as being the proper basis to use for the allocation of securities at the present time as to their relative value.

Q. Well, now, that question in a sense was asked a moment ago in regard to the Milwaukee and Northern, where it is not quite as important as it is in regard to the first and refunding line.

If you will bear with me for a moment. You testified yesterday that in round figures it would take approximately $18,000,000 of earnings to pay out the 5's of '75 on the new capital basis. I am not pinning you down to that figure; that was a rough guess, but I think that is approximately correct. I am speaking of net income, of course.

A. I think that is approximately correct, sir.

Q. Of course, taxes are not included in that, in that estimate, so that it would probably be in excess of $18,000,000.

A. All taxes except federal income taxes and surtaxes on undistributed profits.

3056 Q. I appreciate that, but federal income taxes would take probably a sizeable slice, and that would have to be added because the 5's of '75 would get a large portion in preferred stock.

A. What that would be, when they come to make a report for income tax purposes, I would not want to state, but to whatever extent it was required to pay taxes, federal income taxes and taxes on undistributed profits, that would be added to the figure that you have previously stated is the amount of income necessary to come through.

Q. We are all being a little optimistic in even getting into that discussion of taxes.

Now, on the present basis I think I am correct in saying that the 5's of '75 would be paid out with net earnings of approximately $14,500,000; that is, that income would be sufficient to pay 5 per cent on our present $106,000,000.

Look at your plan. That is Exhibit B, I think, page 53 which would reflect that.

A. I think it would be reflected a little better on Exhibit A, page 49.

Q. Yes.

A. The second column.

Q. Yes.

3057 A. $14,561,478 through 5's of '75.

Q. Now, let us take the same basis for the general mortgage bonds, or the same line of investigation.

On the present basis the general mortgage bonds would

likewise require $14,561,000 to be completely paid out, is that correct?

A. I don't get that. You mean the present?

Q. Before the plan as it now stands.

A. Before the plan? No, the general mortgage would come ahead of the payment on the 5's of '75, I would say, there being a first and refunding mortgage ahead of it.

Q. Well, that is assuming an allocation. Assuming that the income, or that the interest is not earned; I am assuming that the road is—

A. —a going concern.

Q. —a going concern, yes.

A. To keep it out of bankruptcy, the amount that would be necessary—

Q. —would be $14,000,000.

A. The same amount, of course.

Q. That is right.

A. That would be the amount necessary to pay all fixed interest obligations, yes, sir. Your sense was whether that amount would be necessary to go through the general
3058 mortgage.

Q. Well, I was stating it was a going concern, and your general mortgage and your 5's of '75—may I interject there:

At the present moment the first and refunding has outstanding about how many bonds; about $8,000,000, hasn't it?

A. Somewhere over eight, I think.

Q. And those are all pledged with the Reconstruction Finance Corporation?

A. They are.

Q. And from the testimony yesterday it looks as if the Reconstruction Finance Corporation was amply secured?

A. I believe so.

Q. You think it is fair to say that the 5's of '75 have virtually a first lien on the western lines subject only to those pledged bonds of $8,000,000?

A. I would say they had a second lien subject only to the prior lien of the first and refunding bonds.

Q. I am always restless when they are spoken of as a second lien.

Now, under the new plan, fixed interest charges and your contingent share of the—or all of the contingent income on the A's, amounts to $11,949,000, I believe?

3059 A. As I see it here, it would be $11,902,000.

Q. And included in that is an additional $14,990,000 of bonds issued for accumulated interest to the holders of the present general mortgage?

A. Yes, which compares with $18,000,000 of securities issued to the holders of 5's of '75 for their interest.

Q. Correct, coming entirely after the general mortgage.

A. Correct, in accordance with their lien.

Q. Now, coming back to the question that I raised of your taking from the total capitalization, depending upon a normal year, so-called, and your allocation of that capital depending upon the year 1936, taking all of your figures and all of your argument as sound puts us in a position where we cannot come back with improvement of our western lines until after the general mortgage bonds have been completely satisfied.

A. Modifying your question to this extent, that the capitalization was based upon the forecast for the normal year being one of the primary considerations.

Q. I appreciate there are other factors.

A. Yes.

Q. But, without desiring to pin anyone down, it would be fair to say that is the principal justification?

A. That was one of the controlling—

Q. —factors.

3060 A. Yes, in determining the capitalization of the reorganized company, and the capitalization of the reorganized company provides that before the 5's of '75 in any one year receive any income, the general mortgage bonds, new first mortgage bonds, and the new general mortgage income bonds, Series A, shall, insofar as I have testified, have been satisfied, or would satisfy the claims of the old general mortgage and would receive the full amount of fixed interest and the full amount of contingent interest, and in addition to that, the accumulated interest and the Series A bonds to the extent that in the plan, whatever accumulation is provided for, would have to be taken care of.

Q. Now, in regard to the lien, the general mortgage now has a lien on what you have described as the part of the system. You now take into your lien in the proposed plan the entire system?

A. That is correct.

Q. That includes the Terre Haute property?

A. That is correct.

Q. It also has an offset that provides that you take in the Terre Haute bonds?

A. That is true; as an offset.

Q. In other words, you put them on a par with you; also as a lien on the entire system?

3061 A. I am confused there as to whether you mean an offset or as an alternative, when you said we took in the bonds.

Q. Well, I mean as an offset, and what upsets me very much, you are taking a lien on the entire system, particularly our line. The Terre Haute showed a net after payment of interest on those bonds?

A. That is correct.

Q. Even in the year 1936?

A. That is correct.

Q. So did the Milwaukee & Northern in the year 1936?

A. That is correct.

Q. The Gary had a small deficit in the year 1936, and you treat them somewhat differently.

What is the treatment provided for the Gary bonds?

A. The treatment provided for the Gary bonds is 100 per cent in preferred stock.

Q. But the line on which they are a lien comes under the new first mortgage?

A. That is true.

Q. The first and refunding lien, lines west and east, all that property goes under the general lien, too, of the first mortgage?

A. That is true.

Q. Now, I am somewhat puzzled by the reasons
3062 which underlie all of these suggested rearrangements.

There is no provision for new money in the plan, is there?

A. At reorganization?

Q. At reorganization, immediately contemplated.

A. It is believed that no new money will be required.

Q. And there will be $10,000,000 additional first mortgage bonds that are reserved simply for what you regard now as unforeseen but possible requirements in the future?

A. That is correct. That $10,000,000 bonds, of reserve fund bonds, being the limit that will be available for issue, without having improvements and betterments capitaliz-

able in sufficient amount to permit of the issuing of additional bonds.

Q. Well, then, why pick the year 1936 and this particular line to place your bonds definitely on the entire system, relegate the 5's of '75 to preferred stock and a virtual third lien, though I appreciate on the record it is a second lien, but certainly sharing in income, when after all of it has been completed there is no new money and no new interest coming in calling or requiring sacrifices of that type.

A. The new money is provided as shown in the plan by the plan contemplating that no interest will be paid on certain of the bonds during the first current six
3063 months or until such time as the plan is actually consummated.

Of course, if we are running along for several years, which I hope will not be the case, after there are sufficient funds to take care of the reorganization, and the normal requirements for the operation of the property, then if the property still remains in bankruptcy, to the extent that they have excess funds, they should be devoted to the payment of interest on bonds.

Q. Well, didn't the 1935 plan roughly accomplish the same purpose?

A. Which purpose?

Q. Of providing for new money, as you put it, by a waiver of interest requirements.

A. The 1935 plan was a stand-by plan, and in connection with the waiver of interest requirement, the interest not paid was fully cumulative on bonds down through the 5's of '75.

Q. But except for the cumulative feature and a few other changes, such as the betterments, the required A and B funds, and others, except for that the plan accomplishes no more than the plan of 1935.

A. Oh, I would not say that at all. The plan of 1935, as I recollect it—and it has been some time since I read
3064 it over—made definite provision for the repayment in cash of the accumulated unpaid contingent portion of interest on the general mortgage bonds. That was to come back to the general mortgage bondholders in cash. That is one difference.

Q. May I interrupt? You fund it under the new plan?

A. Under the new plan we fund.

Q. On the same basis, and the additional bonds of the same type?

A. Under the new plan we fund the amount that has accumulated up to the date of the reorganization, but in the new plan we fix a limit of fixed interest, or limit the fixed interest that in my opinion can be met under varying circumstances of that type.

Q. Well, there was a difference. It was $6,500,000 in this plan and six million and something in the other.

A. Yes. But, if you follow down the line of the various features of the plan I think you will find that there is quite a material difference in this plan over the plan of 1935.

The plan of 1935 was materially different, and this plan was purely a standby plan to see what would happen.

It was believed what would happen according to the forecast and estimate that was set up in Exhibit 97 would
3065 permit of the plan being the ultimate plan that could remain in effect, since 1935.

Q. And would you say it would not be correct to call this plan a standby plan from everybody's point of view, except the 5's of 75 and the interest below that?

A. I would not think it was a standby plan for them.

Q. For the 5's of '75?

A. No.

Q. Neither should I.

A. Nor for any of the securities. I would say that this is a plan of reorganization that provides for a capital structure that will, in my opinion, place this railroad in a sound financial position on reorganization.

Q. I don't want to continue that line because we will just end up in argument.

Passing that for the time being, was there a severance study made of the western lines?

A. I think not.

Q. It would be a very difficult study to make, would it not?

A. My feeling would be that a severance study would be a difficult study. It calls for a great many conclusions and assumptions in connection with a severance study, and

all severance studies are, in my opinion, rather dif-
3066 ficult studies.

Q. Surely. Have you considered what the line east would do if the western line were scrapped or sold or not in the system?

A. Not in dollars and cents. I believe the eastern line could exist and have substantial earnings without the western line, or without that western line, and I further believe that the practical matter, looking at the railroad altogether as it exists, that the eastern line would not lose all of t traffic that is now interchanged, if we can call it an inter change, between the eastern and the western lines, if the western line were severed from the eastern line and attempted to operate as an independent railroad.

Q. Was there any survey made of bus competition?

A. What was that?

Q. Was there any survey made as to the effect of bus competition and its various effect upon the eastern and western lines?

A. As to the extent of a survey, whether there was such a survey made and its extent, I would not say.

I believe that in these estimates that have been made by the officers of the company, they knew what were the conditions, the competitive conditions and the traffic con-
3067 ditions in the territory, and that they, I would imagine, in working out these allocations, took those matters into consideration.

Q. Your group, therefore, did not make any such survey?

A. We did not.

Q. Did you discuss that aspect with the officers of the Debtor?

A. Of making a survey?

Q. No, the aspect of the effect of bus competition.

A. Not in detail as to that particular aspect, but as is shown in the general assumptions upon which the forecast was made and the general broad assumptions that were made by the Debtor, these various forms of competition were given consideration.

I did not inquire into the extent of a study with respect to bus competition.

Q. In fact, it was one of the very many vague elements in the whole problem.

A. Well, it is not so vague; it is actual. And, the men who were operating the railroad, they realized that it is actual, and in my opinion have an idea as to what extent it does affect traffic, and that is entitled to some consideration.

Q. What you have said in regard to buses—I inadver-

tently used the word "bus" instead of "buses and
3068 trucks," but you were speaking of the combination, were you not? The same answer would apply?

A. I was thinking of buses when the question was asked.

Q. Correct; as you were entitled to. Would you make the same answer in regard to trucks?

A. I think that in regard to trucks, that the Debtor has made more careful surveys in regard to truck competition.

Q. But you have not had discussions?

A. I have not gone into the details of those surveys; no, sir.

Q. You remember getting an expression of opinion in regard to it? Do you remember discussing the subject?

A. I remember that I have frequently discussed bus competition with them.

Q. Of course, but I mean in its bearing upon the allocation of earnings to the lines east and lines west and the prospect of the lines east and the lines west.

A. My only recollection there—and I think it is correct—is that in these various discussions it developed that the lines east are subject to bus or truck competition to a greater extent at present than the lines west. I think that was developed in those discussions; at least, if it did not develop in those discussions, the situation existing
3069 at the present time as it does; that is my recollection.

Q. Now, was any consideration given to the fact that the lines west cover primarily country in the process of development, presumably a country which will develop at a greater rate of acceleration than the district covered by the lines east?

A. I cannot agree with you on that statement that it will develop with a greater acceleration than the lines east, if by "acceleration" you mean that the development will produce a greater increase in traffic to the road than would be developed by the lines east, because of the fact that the Pacific Coast is becoming more and more independent of the eastern section of the country with respect to supplying its own needs, and also because of the very keen water competition.

My observation there is that there is a long strip of country from Mobridge to the Rocky Mountains where the development or possibilities of development, I believe, are hardly present; at least, for development for increased traffic for the railroads. And, west, for quite a distance,

the development depends largely upon irrigation, and when you get to the coast there, as I have stated, the Pacific Coast is becoming more and more self-sufficient in my opinion.

Q. I think you said you are not familiar with the
3070 details of how all the mechanics or how these surveys in Exhibits 140 and 141 were made up, with the allocation of earnings.

A. Only to the extent that I have examined the formulas, which are also exhibits.

Mr. Pantaleoni: That is all.

Mr. Fitzgibbon: I should like to ask a few questions.

Q. (By Mr. Fitzgibbon.) In your direct examination, Mr. Walter, you testified that the value of the lines west was off-set by the deficit. Did any member of your group vote against this plan because the new first mortgage and the general mortgage are going to extend their liens—that is, the lien of those mortgages will attach to the lines west?

A. They did not.

Q. Mr. Colpitts at the hearing on June 16, 1937, stated as his individual view, in addition to that of the special committee that he served, that more intensive studies than any yet made should be made, one, as to the probable future traffic situation in the Debtor territory and, two, the expenditures probably necessary to carry and hold the debtor's share of such traffic.

Do you care to make any comment on that state-
3071 ment in regard to the plan proposed by your group?

A. I think if you will read the record of testimony in connection with that, that he further stated that at that time in his opinion the statement would be of but little value.

Q And you still think that such study as that would be of little value?

A. I did not say that.

Q. Well, I was asking you for your comment in connection with that statement.

A. My comment was that that statement was qualified, as I recollect it. The question of the value of a study, intensive study is, of course, one upon which you merely have your individual opinions and views. These studies as they are made and then as the results are applied are dependent upon and involve a large number of assumptions and the

exercise of judgment on the part of those who make the studies.

My own feeling in connection with this situation is that the studies that have been made to the extent that they are to be dignified with the name of "studies" by the organization of the Debtor, that their own knowledge of the conditions of the property are sufficient to determine the relative value of these mortgages.

3072 There may be differences of opinion on that, but that is my opinion of the studies that have already been made.

Mr. Fitzgibbon: That is all.

Q. By Mr. Orschell.) Mr. Walker, you stated in preparing the plan of reorganization that in fixing the values of the property you gave primary consideration to the earnings; that is to say that you capitalized the earnings in reaching your valuation, is that correct?

A. We gave primary consideration.

Q. And you also stated, I believe, that you had no appraisal made before the plan was prepared?

A. What do you mean by appraisals?

Q. I mean you didn't take an engineer out and have an appraisal made of the various assets and relative values on a depreciated basis, or anything of that kind?

A. No. Insofar as the value of the physical property was concerned, we took the Bureau of Valuation of the Interstate Commerce Commission elements of value.

Q. That is the element of value prepared in August 1936 that you have reference to?

A. I think that was it, as I recollect it, December 31, 1935.

Q. Yes; that is correct.

3073 A. Yes, sir.

Q. Well, as I understand it, the Interstate Commerce Commission has placed a value on these properties in excess of $650,000,000. As a result of your plan, the valuation has been scaled down far below that.

Will you kindly tell me why these values were ignored?

A. They were not ignored, but in reorganization the value of the property under Section 77, when such weight is to be given as it states in Section 77, to the value of the property, the physical property—the valuations of the property as in the light of the earnings, were proper.

Q. Well, I can't understand where the earnings may be

used to determine the minimum values that may be placed upon the properties, but it does seem to me, with a valuation as thorough made as this appears to be, that a top figure could also be derived from that.

I am curious to know that explanation can be made to the stockholders as to why their interest is to be wiped out when we do have reliable information as to what these values are on a comparatively recent date.

A. I should think that the explanation that could be made to the stockholders would be that over a long period of years now—my recollection being since 1917—this
3074 property has not earned any dividends; has not paid any.

Q. Well, there have been some years when the property has netted as high as $32,000,000, is that not correct?

A. But it was all needed for one purpose or another, and no dividends were paid by the board of directors, according to my recollection, since 1917; and during that period of time advances in the art of transportation have taken place which have changed the situation of this and other railroads in the transportation field, and taking into consideration all of the conditions which exist at the present time, the question in my mind is, is there sufficient value and is there sufficient earning power in this property to pay out its creditors?

Q. Mr. Walker, on page 17 of the plan you show the total debt at the present time of $613,000,000, and you set up as your grand total capitalization under the plan the figure of $640,000,000.

Now, I am thoroughly aware of the fact that you have given $100 value to the common stock, which you have stated is to be no par value, and I understand you would not want to be foreclosed on or construed to say that that value does have $100 per share, nevertheless, you are stating it as a hope, shall we say, that those properties
3075 will regain a value of $640,000,000; is that not correct?

A. Stating it as an illustration and to show what will be necessary for this property to have as value in order that the creditors may be reasonably satisfied with respect to their claims.

Q. Well, if that value does return to $640,000,000—let us hope that it does, but we are just guessing at it—if that value does return to $640,000,000, then isn't it true that all

of the benefits of that increase between $613,000,000 and $640,000,000 should redound to the benefit of the stockholders and be returned to the stockholders, particularly the preferred stockholders?

A. But that increase in value can only come by reason of the fact that the present creditors have contingent interest bearing obligations, the accumulation of interest upon which is limited, and also because of the fact that the present creditors have preferred stock, the dividends upon which are non-cumulative, and therefore the restoration of this property to a point where it may have this value will be made, in my opinion, out of the money that is really money belonging to the creditors.

Q. Well, except if it does regain that, the creditors will have more than they have today?

3076 A. They will have more in it by losing the income in the interim. The proper compensation will not be the $613,000,000.

Q. I take it that in considering the plan of reorganization and preparing it, you never seriously considered allotting any block of the new stock to the preferred stockholders?

A. We did consider seriously the question of whether or not stock could be allotted to any of the present stockholders, preferred or common.

We did consider seriously the question of whether or not there was any value in the equity, and if we could reasonably see any value in the equity, certainly that value could be passed along, but in my opinion there is no value to the equity.

Q. You have said, Mr. Walker, I recall in your testimony, that you also considered the advisability of issuing warrants to stockholders and that you decided that it was not advisable; that the stockholders would not care to exercise those warrants anyhow.

A. I think your recollection is incorrect. I think my statement was to the effect that we considered the question of whether or not the stockholders would take an assessment; not warrants.

Q. Take any what?

3077 A. Take an assessment; not warrants, which would pay off the losses and provide sufficient reserve and retirement funds, and in exchange for the assessment, or rather for the assessment would be willing to accept securities that were junior to the claims of the creditors.

3078 Q. You are, of course, familiar with the provisions of Section 77 that authorizes the issuance of warrants to a stockholder, or stockholder interests, in railroad reorganizations?

A. Section 77, I believe, permits—

Q. Permits the issuance of warrants—

A. Under conditions specified therein the issuing of warrants.

Q. I did not mean to imply by following this line of examination that the preferred stockholders would be satisfied with warrants. I would like to inquire whether or not you considered the advisability of giving warrants? You discussed the question of adjustment, How about warrants? Was that considered at all?

A. Warrants? Feeling that the value of the equity of the preferred and common stockholders had no value, that there was no value in the equity of the preferred and common stockholders, then there was nothing of value there justifying the issuance of warrants because we must either say that the warrants have no value or that there was value.

Q. You are hopeful that the railroad, should there be a return to what we hope will be normal conditions, under your capitalization will be a good value and that the securities will have a value?

3079 A. Yes, sir.

Q. So on that basis there is a possibility those warrants may have a very distinctive value?

A. There was no value in the equity at reorganization that entitles, in my opinion, the stockholders to receive anything in value for their equity.

Q. We are not arguing that.

A. If the warrants have value, then they will be given something of value for something that has no value.

Q. Was the question of treatment of the preferred stockholders discussed by your Committee with any of the stockholders?

A. No, it was not.

Q. They were not consulted in connection with that?

A. No.

Q. Let me ask you one more question. It is rather collateral. I would like to understand the procedure in connection with the Chicago, Milwaukee & Gary situation. If I recall your testimony correctly, you stated that the

value of the assets of that line were less than the amount of the bonds. That is the Gary.

A. If I made that statement, the value of the physical property was taken from the Bureau of Valuation, but I will have to check and see whether or not I made—

Q. I am sorry I have not seen the testimony.

3080 A. I will have to see whether or not I did make that statement, and if so, I believe it to be correct.

Q. I wish you would.

A. I cannot put my fingers on it at the moment.

Q. Perhaps I should reserve the question. You may check it up. I do not want to take the time now. May I ask you this one question a little bit later? I do not want to take the time now. This is the only other question. It was my understanding, Mr. Walker, that you stated the value of the assets under that mortgage was less than the amount of the mortgage. I note under the plan you were allotting to the Gary mortgage bondholders of 5 per cent preferred stock the full amount of their claims. I was curious to know why it was all those assets were of less value than the amount of the mortgage charges and the security holders should be allowed at least the opportunity to come out whole.

A. I have the statement now and I think you are mistaken as to my stating that the elements of value of the physical property of the Gary were less than the bonds.

Q. Let us pass it for the moment.

A. That statement was not made.

Mr. Swaine: I think Mr. Orschel may be confusing your testimony with the Commission's own report which

3081 does show the fact he is trying to get at.

Mr. Orschel: That is all. I would like to check a little further on that.

The Witness: I did not make that statement.

Director Sweet: Any other cross-examination?

Q. (By Mr. Swaine.) Mr. Walker, in your examination by Mr. Panteleoni you referred to the almost daily discussions that took place during June, 1935, in connection with the 1935 plan. That was a period of very intensive work, was it not?

A. It was.

Q. In which the representatives of the Debtor were in daily cooperation with the representatives of the creditors?

A. Almost daily.

Q. During the course of that negotiation, you found

that the Debtor and its officers and counsel were anxious to recognize the priorities of the creditors, did you not?

A. I did.

Q. You found also that the Debtor, its officers, directors and counsel, were anxious to give to the creditors a major voice in the determination both of the substantive provisions and the expression of those provisions?

3082 A. I think that is correct, according to my recollection.

Q. As a matter of fact, the creditors' representatives did have a substantial voice in determining not only the substantive provisions of that plan, but the manner in which they should be expressed?

A. I think that is correct.

Q. Is it not also true that during the course of that negotiation, Mr. Jesse Jones, Chairman of the Reconstruction Finance Corporation, was consulted as to various provisions of the plan?

A. I believe he was consulted.

Q. You were advised by officers of the Debtor that he had been?

A. I think that is the case. I know there were consultations with Mr. Jesse Jones, Chairman of the Reconstruction Finance Corporation, in connection with that plan, but I did not participate in those conferences.

Q. Letters which were introduced into the record in the 1935 plan from Mr. Jones to Mr. Scandrett with reference to the contingent interest provisions of the General Mortgage bonds and with reference to the treatment of the adjustment mortgage bonds were shown to you and your representatives at the time, were they not?

A. I think that is correct.

3083 Q. And the points raised by Mr. Jones—the creditors were unwilling to yield as to some of those points, is that true?

A. I would not say that was the situation. With respect to some of the points that were raised, conferences were held with Mr. Jesse Jones, Chairman of the Reconstruction Finance Corporation by certain members of the informal group. My recollection is in connection with that that Mr. Jesse Jones, Chairman of the Reconstruction Finance Corporation, and the Debtor and our group reached an agreement.

Q. I think that is the more correct way of putting it; but so far as the first request of Mr. Jones was concerned,

you did not accede to that with the result that there was a failure of mutual agreement?

A. (No response.)

Q. Would it not be better to say that this foundling which counsel thought the other day had been abandoned, had as its father a syndicate composed of the creditors and debtors in which the R. F. C.—

Mr. Burgess: I did not say it had been abandoned. I said I did not think it had been abandoned.

Mr. Swaine: My point is it was the product—

A. I would not say it was a syndicate. I would say that the parties in interest, having substantial inter-
3084 ests in this property to the extent they could be determined who they were, got together as a result of repeated conferences and intensive work and this plan of 1935 was produced.

Q. Now, during the period from 1935 to June, 1937, the officers and counsel of the Debtor from time to time discussed the development of the situation with you and your counsel, did they not?

A. Very frequently.

Q. In June of 1937 the Debtor's officers and counsel advised you, did they not, that because of the rising cost of materials and supplies, as well as threatened increases in scales of wages and increases in pensions, unemployment taxes, and uncertainties as to the future trend of those items, they felt it was impracticable to go ahead with the 1935 plan at that time and in their opinion those uncertainties were such as to require a deferment of the reorganization?

A. I couldn't state as to whether right at that particular time we were advised that with respect to all of those items, but that was just the situation.

Q. You were advised in advance of the June, 1937, hearing, that would be the position of the debtor?

A. I think that is correct, sir.

Q. Your Committee did not dissent from that view?

3085 A. We did not dissent or assent. We did not dissent from it or assent to it.

Q. At the June, 1937, hearing you did assent. I am talking about June, not September.

A. I would have to refresh my recollection as to that.

Director Sweet: Is this material?

Mr. Burgess: Let us let the record speak for itself, pretty distinctly what was said at that time. I would rather have the record speak for itself. I could state my recollection.

Q. (By Mr. Swaine.) In September, 1937, did you not agree with the Debtor that it had become even clearer than it was in June that a plan having the capitalization of fixed charges and contingent charges contemplated would not for the immediate future be regarded as sound in light of the then existing conditions?

A. I do not know as I said exactly that, Mr. Swaine. I think I expressed myself at that time as I feel now, that the increases in the cost of materials, wages and other items, as stated, must be taken care of or compensated for by rates or otherwise.

Q. But the uncertainties in September, 1937, were so great as in your opinion to make it unwise to go ahead with a plan having a capitalization that the 1935 plan contemplated; is that not so?

3086 A. Whether I expressed that opinion to you or members of the Debtor's organization, I do not recollect; but I was of the opinion then, and I am of the opinion now that under the conditions which developed, with the conditions under which the institution composing the informal group and later those that made up the formal group met, it was stated that the plan of 1935 would receive the recommendation of all members to their respective companies if reorganization was promptly brought about and that they would accede to the plan. Those conditions disappeared.

Q. Quite apart from the question of promptness, and I am not in any wise endeavoring to point out that your Committee agreed to the 1935 plan—I recognize that the condition you imposed of prompt carrying out had passed out of the picture. I am talking about the character of the capitalization proposed and the fixed and contingent charges contemplated by that plan and if that plan was such that in September, 1937, you agreed with the Debtor it could not be relied upon to produce a sound capitalization?

A. I do not know whether I agreed with the Debtor as to that. Those are my views.

Q. Those are your views?

A. And at that time.

3087 Q. You agreed that was so in September, 1937?

A. I agreed at that time that plan was not, in my opinion, a plan—

Q. That would produce a sound capitalization?

A. —that would produce a sound capital structure. I might add that at the time the plan was originally negotiated, there was at that time a decided feeling a more realistic plan might well have then been considered; but in the light of all conditions existing and in the interest of prompt reorganization, the plan of 1935 negotiated as you have described with the Debtor, the principal creditors that could be found and the Reconstruction Finance Corporation as a definitely stand-by plan seemed to me to be sound.

Q. The ultimate capital structure had to do with the period ten years off. When you talk about the realistic situation, you are talking about the period that was to begin in 1945?

A. No, we were not.

Q. Because in the intervening ten years the fixed charges were to be limited to seven million only?

A. No, we were not when we were discussing the realistic plan. The question was whether initially, not at the end of 1940, whether then a realistic plan should be proposed. The question was as to whether we might not
3088 take the bull by the horns in 1935 and have a realistic plan then rather than a stand-by plan, but the conclusion was reached that under all the circumstances the stand-by plan would work probably to the advantage of all parties in interest.

Q. During the ten year period, 1935 to 1945, the capitalization had a realistic fixed and contingent charge, did it not?

A. I think you may say that the fixed charge at that time was a realistic charge.

Q. Now, following the refusal of the Commission to grant an adjournment at the September hearing and the filing by your Committee of an application for reopening in which you agreed to propose a plan, did the officers or directors of the Debtor get in touch with you promptly?

A. I think they did, yes, sir.

Q. There was a meeting at the New York Life Insurance Company within a very few days after the granting by the Commission of the further reopening of the case?

A. I think that is correct.

Q. Is it not correct to say that the sub-committee of the Board then asked you to canvass the situation and state to the Board how far you would be willing to have the lien of the general mortgage displaced in order
3089 to provide a financing medium?

A. That possibly might have been—

Q. Well, it really was, was it not? Was that not one of the real problems involved in the 1935 plan, the question of providing a financing medium?

A. That was one of the questions that was brought out.

Q. The other principal difficulty—

A. But I do not recollect whether at that particular meeting that statement was made or the question asked at that meeting.

Q. We were discussing the program, were we not, there?

A. I think so.

Q. We had had a good deal of discussion about the question of providing a financing medium for the reorganized company, had we not?

A. I think that is correct. There was a discussion in the record on that.

Q. One of the difficulties in the 1935 plan was the uncertainty as to whether it provided an adequate financing medium?

A. I think that is correct.

Q. And the other financing medium there provided was a first lien on all of the lines west and certain of the lines east ranking equally with the R. F. C. bonds? That
3090 is, the old first and refunding mortgage was the financing medium?

A. That was the financing medium, being only a first lien on western lines and a junior lien on eastern lines.

Q. The other principal difficulty that we saw there was the feature regarding accumulation of interest on the 50-year 5s over a period of 10 years; that was regarded as a definite weakness in the capital structure, even for the 10-year period?

A. There was a full accumulation provided.

Q. Is it true that at the October meeting with the sub-committee you said that you would be unable to answer the Special Committee's questions until you had obtained further information from the Debtor?

A. That is correct.

Q. You asked that the representatives be given access

to the Debtor's accounts, for instance, and records, so that you could obtain this information?

A. That is correct.

Q. And that access was given, was it not?

A. It was.

Q. Fully?

A. Fully.

Q. And in a thoroughly cooperative spirit?

3091 A. In a thoroughly cooperative spirit.

Q. Immediately following that period you and your counsel necessarily were primarily engaged in the matter of the Chicago & North Western reorganization, were you not?

A. I could not say whether it was immediately following or not, that date.

Mr. Burgess: We had a hearing down here in December, Mr. Swaine. I would be willing to stipulate that. We had our work and we did it thoroughly. We are here with a plan. We have introduced it, and we have offered evidence about it. We have no apologies to make. We have conformed to the letter to the Commission's requirements.

Q. (By Mr. Swaine.) When was your Chicago, Milwaukee & St. Paul plan first prepared, and I mean the first proof?

Director Sweet: I must confess that we fail to see any point in all this examination at all. We are not interested so much in whether Mr. Burgess and Mr. Walker were busy with something else while preparing this plan. I do not think that is going to affect the matter.

Mr. Swaine: The purpose of the examination is this:

3092 The mortgage trustees have said there has not been an adequate opportunity to examine into the fundamental matters affecting this organization. The purpose of this examination is to show, to put it very bluntly, that this plan was prepared to meet a dead line set by the Commission. It was prepared hurriedly, and necessarily under tremendous pressure on the part of the institutional committee and their counsel, through no fault of their own. They were busily engaged in other matters. They had no opportunity to discuss the matter with the Debtor or other people. Therefore, this plan in contrast to the 1935 plan is not the product of discussion.

Director Sweet: Have you not already the basis for an argument of that kind?

Mr. Swaine: No, not until I get the facts as to this plan. I want to develop the facts as to when the plan was first developed and the fact it was not taken up with the Debtor. I have not asked that question.

Director Sweet: Is it not more a question for us to know what are the merits and defects of this plan?

Mr. Swaine: We are going into that, but I want to—

Director Sweet: You better get to it pretty soon.

Mr. Swaine: I want to develop the fact we have not had an adequate opportunity, and it appears in the motions which the mortgage trustees have already made and
3093 in the motion which the Debtor will ultimately make as to further time to consider modifications of this plan.

Director Sweet: If that is the only purpose of it, we will not need much more discussion.

Q. (By Mr. Swaine.). When was the first plan taken up with your committee?

A. The latter part of February.

Q. The latter part of January, you mean?

A. January.

Q. You do not mean the latter part. It was about January 8th, was it not?

Mr. Burgess: It was filed on the 10th of January.

The Witness: I would have to refer to the record for that.

Q. (By Mr. Swaine.) Was it ever submitted to the board of directors or the special committee of the board prior to its adoption by your committee?

A. Yes, sir. It was sent to the directors so that it was in their hands.

Mr. Burgess: I do not think you understood the question.

Q. (By Mr. Swaine.) Was it ever submitted—

Mr. Burgess: The question was whether it was sub-
mitted to the board of directors or the debtors prior
3094 to its submission.

The Witness: No. He did not say "submission".

Mr. Swaine: Yes.

The Witness: I thought you said approval or adoption by our committee.

Q. (By Mr. Swaine.) Yes. Was it submitted to the board of directors prior to its adoption by your committee for discussion?

Mr. Burgess: It was not formally submitted to your committee until on the 10th of January.

Mr. Swaine: It was first submitted to the board of directors simultaneously with its filing?

Mr. Burgess: I do not know what you did with it. It was submitted.

Mr. Swaine: It was first given to the directors of the debtors simultaneously with its filing, was it not?

Mr. Burgess: That may have been the case.

Mr. Swaine: There was no opportunity—this is not critical at all—

The Witness: I am looking back over that. I have to sort of look back and put these things together. I think you are correct in stating that upon the filing of the plan copies of it were then sent to the parties in interest.

3095 Q. (By Mr. Swaine.) So there was no discussion as between your committee and the Debtor, either as to the substantive provisions or as to the manner of their preparation?

A. Prior to the filing, no.

Q. Now, did the officers and counsel of the Debtor thereupon ask for an opportunity to meet with your committee and discuss the provisions of the plan?

A. They did.

Q. We had a meeting, did we not, at the New York Life Insurance Company on January 20th?

A. There was a meeting in January.

Q. On the previous day there had been supplied to you and to the members of your committee a proof of modification suggested by the Debtor, had there not?

A. That is true.

Q. A revised proof was submitted at the meeting on the 20th?

A. That is correct.

Q. We met for a period of two hours, did we not?

A. I should say thereabouts.

Q. At the time that the meeting broke up, do you remember that I said I hoped after you thought this over we would have an opportunity to come back and talk about the matter with you?

3096 A. I think that is correct.

Q. We have not heard from you about that since and until we came down here?

A. I think that is—

Mr. Burgess: I do not think that is correct. We did send you a copy of the modified plan of reorganization, dated January 24th. I furnished it to you and to the officers of

the Debtor, and advised—it may have been orally—that that incorporated such of the modifications that you suggested that we felt should be incorporated.

Q. (By Mr. Swaine.) So the only opportunity for discussion and the only discussion that was had was two hours on January 20th?

A. I think that is correct.

Mr. Swaine: Will you mark this for identification?

(The document was marked Exhibit No. 189 for identification.)

Q. (By Mr. Swaine.) Following the January 20th discussion of proof, did you and members of your committee receive from the Debtor a document entitled "Modifications suggested by the Debtor of the plan of reorganization dated January 7, 1938, prepared by a group of institutional investors of the Chicago, Milwaukee, St. Paul & Pacific Railroad Company", in the form of this ex-
3097 hibit?

A. Which edition is this?

Q. This is the final one as filed. Did you receive a copy of it?

Mr. Burgess: I think that is the one you got Monday.

The Witness: This Exhibit No. 189 I received on January 31.

Q. (By Mr. Swaine.) I suppose you have not had time to compare that with the proof you received on January 20th?

3098 A. No, I have not compared it, but if these are the modifications that the Debtor now proposes, I have examined those modifications.

Q. And those vary from the modifications suggested in the proof only in relation to the treatment of the stock, and by the addition of a provision preventing the pledge of the bonds at more than 150 per cent of the primary debt, a provision which I believe you will remember was suggested by a member of your committee.

A. I couldn't say whether those were all the changes or modifications, but—

Q. Well, having prepared both of them I will state so that we can assume it from this point on as the basis of our discussion, because I do not want you to have to discuss something that you haven't had a substantial length of time, but those are the only two differences, substantive differences between the proof which you had on January 20th and the document which is now here of which fifteen

copies were filed with the Commission and before the beginning of this hearing.

Now, Mr. Walker, have conditions, in your opinion, grown better or worse since September, 1937 with respect to the possibility of the railroad reorganization?

A. Why, I think that we are making progress to-
3099 wards reorganization.

Q. Has the financial condition of railroads generally improved since September, 1937?

A. I think not.

Q. Has the financial condition of this railroad improved since September, 1937?

A. I do not think that it has.

Q. Have any of the uncertainties which were frankly discussed between your Committee and the Debtor in September, 1937 been removed since that date?

A. No, but I think they are approaching removal.

Director Sweet: Do you think there is any prospect that uncertainties are going to disappear in the future?

The Witness: Not all of them, no. There will always be uncertainties in the Railroad business and in its present competitive situation.

Q. (By Mr. Swaine.) One of the principal uncertainties is the question of the rate level, is it not, Mr. Walker?

A. Those uncertainties will always be with us.

Q. One of the principal uncertainties today is the question as to what the rate level will be, is it not?

A. That is one of the uncertainies, but that, due to
3100 the expeditious manner in which it is being handled, will shortly be disposed of, so that we will be able to determine just what that situation is.

Q. Well, expecting that to go in as of next month or the month after, the earnings on this property are not sufficient to support a capital structure involving the fixed charge of $6,556,000 and a possible contingent charge of $12,000,000, are they?

A. Not the contingent charge added to the fixed, no.

Q. Isn't it almost certain, in the light of earnings, that full accruals will develop on the contingent charge bonds which you propose?

A. I wouldn't want to say that that is almost certain.

Q. What were the earnings of this property for the last six months of 1937?

A. I do not think a six months' period is at all a con-

trolling period, and as to the six months, I haven't those earnings here, but the earnings for the twelve months, that is—

Q. Well now, wait a minute. I do not want the twelve months. I would like to have the last six months. You will agree, will you not, Mr. Walker, that the down trend in railroad earnings came before the past six months?

A. Six or seven months, yes, sir.

3101 Q. Therefore, if you are studying trends you would be interested in the last six months?

A. Oh, no, the trend of so short a period as six months is of little value.

Q. Well, do you see at the moment any basis for hope that that trend will be promptly reversed?

A. Oh, I can see at the moment hope that the trend in railroad revenues will be reversed.

Q. When?

A. Well, I think after the Commission's decision is rendered, I think that this country is not going to go entirely bankrupt and that with the lack of piling up of inventories, with the lack of generating capacity in connection with the public utilities, with the lack of housing and the other lack of necessities that will require investment of large sums of money, that it is not going to be a very long time before there will be a substantial upswing in the volume of business.

Q. You think that is more certain today than it was in September, 1937?

A. The time of the upswing I think is closer.

Q. By four months. But you think that there has been a sufficient clarification since September, 1937?

A. What is that, please?

Q. You think that there has been a sufficient clari-

3102 fication since September, 1937 to permit the fixed charges of $6,556,000, nearly, when $7,100,000 were unwise in September of 1937?

A. Well, it wasn't just $7,100,000 of fixed charges in September, 1937, that it was the unwise provision.

Q. That was one of them, though, wasn't it?

A. Oh, that combined with the other features in that 1935 Plan made the situation such that in the light of what has transpired I think that the conclusions that were reached by the Debtor and the conclusions reached by me personally have proven to be sound.

Q. Now, the fixed charges which you proposed, to-

gether with your mandatory additions and betterments, would not have been covered by the average earnings in any of the five year average periods which you show on page 11 of your Plan except 1930-1934, would they?

A. Would you read that, please—

Q. The sum of your fixed charges and your mandatory additions and betterments fund—

(Question read.)

Q. —(Continuing.) would not have been covered by the average earnings in any of the five year average periods which you show on page 11 of your Plan except 1930-1934, would they?

A. That is correct.

3103 Mr. Burgess: Well, what did you mean "mandatory," the Plan does not state them as mandatory.

Mr. Swaine: Mr. Walker has referred to the Additions and Betterments Fund as a mandatory fund several times.

The Witness: If earned.

Mr. Swaine: Oh, certainly, I understand that, mandatory if earned.

The Witness: That is, insofar as the—

Mr. Swaine: I mean the earnings would not have been there for the fixed charges and this fund?

The Witness: That is correct.

Q. (By Mr. Swaine.) Now, similarly, if you will turn to page 10 of your Plan, in connection with the years shown, except 1930 and 1931, 1933, and 1936, would they have been covered, would they have been covered, is that not correct.

A. That is correct.

Q. And in the year 1937 they would have been covered with a slight margin, would they not?

A. I imagine so.

Q. Well, the earnings were $9,824,000, I think the record already shows.

Now, the result of that on that average basis, your fixed interest on your General Mortgage Bonds obligation,

3104 Series A, would have fully accumulated to the extent permitted, is that not right?

A. On that average basis?

Q. Yes.

A. But you start in from 1936, and then look for the increase in earnings, there would be sufficient to pay something of interest on income bonds.

Q. I am just applying it to the facts now; we will come to the future later on.

A. Yes.

Q. Now, it would only be in the year 1936 that you would have been able to pay full interest even on the Incomes, is that not so?

A. I think that is correct.

Q. So that so far as the past is concerned, this plan has something of the same defects that appears, perhaps not to the same degree, in the 1935 plan, somewhat the same defects with reference to the accumulation of interest which may not be paid?

A. That is insofar as the immediate past is concerned.

Q. Yes, so far as this period of 1930 to 1936 is concerned.

A. That is correct.

Q. Now, do you think that in the light of today's earnings record you have provided a present financing
3105 medium for this property.

A. Based on present earnings?

Q. That is right, you couldn't sell those bonds.

A. No, not based on the present earnings.

Q. Therefore you have no medium for financing corporate expenditures other than the additions and betterments fund.

A. And the retirements charged to operating expenses, and the depreciation charges.

Q. Well, suppose we go into that. You estimated as the amounts available, I think the testimony already shows, $6,014,000 annual depreciation charged to operation and $1,000,000 charged to road retirement operating expenses, $1,150,000 recovery of salvage, and in the years when you earn the full additions and betterment fund, which you testified has not been done in any of your average periods, a total of $10,763,000.

Now, of course—

A. (Interposing.) I would like to correct that figure there in adding, it should be $10,702,000 instead of $10,762,000. I think that in typing that they mistook the figure.

Q. I appreciate that was your testimony and I hadn't added it.

A. Yes, sir.

3106 Q. Now, of course, so far as the past is concerned, that amount would not have been available, would it, because the additions and betterments funds was not earned.

A. In the immediate past?

Q. That is right, since 1930.

A. No.

Q. Indeed I think is it not true that we saw that it would take $9,094,000 to provide the fixed charges and your full additions and betterments fund?

A. I think that is correct.

Q. And your averages in 1931-1935 and 1932-1936 fell short of that by over a million dollars, and in your six year average of 1931 to 1936 fell short of it by about $500,000?

A. That is correct.

Q. So there would have been materially less than that $10,702,000, applying your plan, had it been in operation, during this last six years for the additions and betterments. Now, that covers both your retirement fund and your additions and betterment fund, doesn't it?

A. It does not include the retirement fund.

Q. Oh, yes, it does, estimated annual depreciation charges to operating expenses $6,014,000.

3107 A. Oh, that is what you recall the retirement fund.

Q. Yes, that is retirement, isn't it?

A. I was confusing that. You were referring to this retirement of way and structures.

Q. No, but what I am trying to point out is that your total available for additions and betterments, had your plan been in effect, would have been less than $10,000,000 a year, on the average.

A. During a depression period as serious as 1931-1936.

Q. Yes.

A. That is correct.

Q. That is all we are doing now, we are merely applying it to the past; we will apply it to the future later on.

A. Thank you.

Q. Interpolating here, if you did apply it to the future, until you got up, until your earnings got to be $15,000,000, this $10,702,000 is your estimated maximum, is it not?

A. Yes, I think so.

Q. That is the estimated maximum until earnings have exceeded $15,000,000?

A. I think that is correct, sir.

Q. Now, the record shows that Mr. Scandrett has already testified that the average annual expenditures

3108 for additions and betterments to road property and system equipment which will be required over the

next five years will be approximately $6,000,000; do you dispute Mr. Scandrett?

A. What was that testimony?

Q. That the average annual expenditures for additions and betterments to road property and system equipment requirements over the next five years will average $6,000,000 per year.

A. That may be what, as he sees it will be required and if that is required I think you will have substantially more earnings than the property now has. Otherwise, I do not think it will be required, and otherwise I do not think that there would be justification for that expenditure.

Q. Won't they have to make those expenditures in order to hold their competitive situation with other railroads?

A. I doubt that. Now, these expenditure estimates that have been made have recently been considered from two categories, one the obligatory and one the desirable ones, ones that are necessary, obligatory. And my feeling is, in connection with this estimate that was made by Mr. Scandrett that they do not, all of it does not come within obligatory expenditures and that the portions of it
3109 that do not come within obligatory expenditures if made will result in substantial increase in income otherwise there would be no justification for making the expenditures.

Q. Well, even the so-called forecasts have been taken into account, have they not, the income which will result from the making of these capital expenditures and indeed have been predicated upon the making of these capital expenditures.

A. These forecasts that are made here are made on the basis of the property existing with the necessary expenditures to keep it in a safe operating condition and to properly serve the public.

Q. Did not Mr. Sparrow in his testimony in the 1935 hearing testify that those computations were based upon the making of six million dollars of additions and betterments per year.

A. I would not be able to say whether he did that or not. The record will show.

Q. You found Mr. Sparrow and Mr. Scandrett not to be wasteful operators, didn't you?

A. I have great respect for their operating ability.

Q. And for their judgment as to what is advisable in respect to additions and betterments?

A. I have; but when it comes to a forecast for
3110 the future, I think that it is quite within the facts that in those forecasts there are included what they would like to have come to them and be used in the operation of the property if the earnings are such that those additional expenditures can be made, and they see that income will flow from it.

Q. Well then, is your plan predicated upon the theory that the property should be starved?

A. That is not starving a property, but it is made on the basis that, in my opinion, there have been large amounts of money wasted in railroads generally in expanding facilities when there were more facilities available than the railroad could now properly use, in a race between competing railroads, and putting in fast freight service, and a race between competing railroads in putting in faster trains, more fast trains than were justified, operating on the competing roads between competing points.

Now, my plan is based upon the theory that the railroads today and in their future expenditures must make only such expenditures as are necessary to serve, properly serve the public and are necessary for their coordination, joint use, and pooling, and in my opinion, if the railroads do not coordinate and there is not joint use, there is no aban-
3111 donment of facilities, duplications of service, and if there is no pooling then the railroads today have a very much more difficult situation to meet in comparison with the competition that they must meet than they will have if they do what should be done, in my opinion, along those lines.

Examiner Jameson: Well, Mr. Walker, wasn't it your plan that the two and a half million dollars would be the cash expenditure?

The Witness: That is the cash expenditure as I have outlined it, it is cash expenditure coming from the earnings, plus the cash expenditure.

Examiner Jameson: It would not be the whole expenditure for improvements, would it, necessarily?

The Witness: Only in the event that in the period of years of extreme depression the securities would not be salable, then these funds set up here would have to be used for the payment of additions and betterments.

Q. (By Mr. Swaine.) Well, I am trying to get at the amount that your plan would provide and find out how the money would have to be financed, and then see if we can find an available means of financing.

Now, Mr. Scandrett, at the September hearing, also testified that the average annual expenditures for new
3112 equipment on the property in his judgment for the next five years should be $7,000,000 a year. Now, the result of that, assuming 25 per cent initial payment would be that $1,750,000 a year, on the average—by the way, did you discuss in connection with your Plan this additions and betterments program with Mr. Scandrett?

A. I can't say that I did discuss the additions and betterments program.

Q. Did you discuss the equipment program with him?

A. I did bring up the question of the equipment program.

Q. Do you dissent from his conclusions?

A. I dissent from the necessity of considering it on the basis of an expenditure of $7,000,000 a year going into new equipment, that is, to set up the $7,000,000 a year going in each year, and I also believe, and I do not think it is his opinion that $7,000,000 has got to go in every year.

Q. But this is the average over five years.

A. All right.

Q. $35,000,000 in the next five years.

A. All right. And I also believe that if the depreciation charge against operating expenses is segregated, as provided in our plan, and applied on equipment, primar-
3113 ily on equipment, and not, as in the modifications used in effect as though it were a general fund and applied generally for additions and betterments, substantially more than 25 per cent can be paid down on equipment trust in years like the present time when your additional equipment requirements are low, reducing the fixed carrying charge, reducing the equipment trust charge outstanding as to principal, and the annual charge as to principal, and that eventually, eventually the equipment should be purchased with a very much higher cash payment than 25 per cent, which is now customary, and I believe that can be done.

Q. That would go to increase your cash required, in order to be fair in the application of an average, let's assume 25 per cent, that would take $1,750,000, if Mr. Scandrett is right, an average of $1,750,000, and you have got

to deal with averages here, you can't deal with what will happen in any year, and I am taking a five year period.

A. Okay.

Q. Now, the average equipment obligation maturities, based on this assumption, this equipment program, and the outstanding equipment is $5,174,000, is it not, over the next five years?

A. I could not say as to that.

3114 Q. You mean you do not have that figure before you?

A. There was an actual schedule laid out as to what that would be, I think, and maybe I can get it, because I went through with it.

Q. Well, if you will accept that figure, subject to correction, of $5,174,000.

A. No, I do not accept that figure subject—

Examiner Jameson: Is that the average total maturities?

Mr. Swaine: Yes. That is the correct figure, is it not, Mr. Oliphant?

Mr. Burgess: Mr. Walker is on the stand, I thought, Mr. Swaine.

Mr. Swaine: All right, I yield to your formal objection.

The Witness: Total principal payments on equipment trusts, 1937, $2,761,588.

1938, including payments on new equipment trust which would be issued according to this schedule during that year, during 1937, $3,883,278.

Q. (By Mr. Swaine.) We are talking about the next five years, Mr. Walker.

A. 1938, $3,883,278.

1939, $4,668,252; 1940, $4,788,262; 1941, $6,004,999.

3115 Examiner Jameson: Pardon me, have you a Series R in there, do you know?

The Witness: Yes, sir.

Examiner Jameson: I see, alright.

The Witness: Series R, goes down to Series R. Now, that is the basis—

Mr. Swaine: Have you given 1942 yet?

The Witness: $5,518,000, 1942; 1943, $5,251,000; 1944, $4,668,000.

Q. (By Mr. Swaine.) Well, you have passed our five year period. We are trying to deal with a five year average.

A. 1945, $3,864,000. The reason for the five year aver-

age, or including the five year average, being on account of postponement of certain depreciation payments, on account of old equipment trusts outstanding which happens to bring about a maximum in that period.

Q. That is quite true, but they will have to be met, won't they?

A. On the other hand, however, if the funds from your depreciation reserve are not diverted—

Q. We have already got that in, Mr. Walker, I put them in.

A. Well now, just a minute. If the funds from
3116 your depreciation reserve are not diverted for other purposes you will not have this large increase in equipment trusts outstanding because the balance that is left over can be used to pay down on the cash price on the purchase of equipment and a very substantially smaller amount of equipment trust will be outstanding.

Q. Well now—

A. On that basis the maturities annually will be substantially less.

Q. Would you mind, for the purposes of this discussion, limiting equipment to that bought through cash expenditures.

A. That I think is a proper limitation, in my opinion.

Q. Well, what difference—

A. And the funds that could go into that depreciation on equipment, which represents the disappearance of a useful life in that equipment, and that should be used for replacement of equipment, and keeping the road fully equipped.

Q. Well now, we will do it the other way then, and we will split our $10,000,000 into two funds. I thought it was easier to take the aggregate, but your depreciation estimate is $6,014,000, isn't it?

A. Yes, sir.

Q. The average equipment maturities are $5,154,800.

3117 A. Not any permanent average at all.

Q. Now, I was talking about the next five years, Mr. Walker, solely.

A. Next five years, provided you bought $7,000,000.

Q. That is right.

A. Of new equipment each year.

Q. Which Mr. Scandrett testified was his advice.

A. But he isn't doing it, that was testifying, was testified to on the basis of what he thought might happen in the future.

Q. What he thought ought to be provided for.

A. What he thought probably might happen in the future. Now, that is not any positive figure, and as a matter of fact, under present conditions, and we are talking more or less about present conditions, there isn't that necessity, and it isn't being purchased.

Q. Well, your plan is predicated then upon cutting down the equipment purchases from what Mr. Scandrett testified in September he thought was the desirable program.

A. It is not. I laid out a schedule in setting this out to 1953, on a basis that over that period of years there would be an average of $7,000,000 of equipment necessary per year, just to see how that would come out, because we are vitally interested in this case, having our money in
3118 the railroad. And that develops that out of the depreciation reserve you can pay the maturities of existing equipment and the maturities of additional equipment, and within a very few years, I have forgotten just the exact number, you can pick up the deficiencies in the $7,000,000 which during these early years would not be required by reason of the lack of traffic, lack of business return, and if the business return comes, that is another situation, within that period, and you can get up and make up your deficiency, $9,000,000 worth of equipment a year for several years and pick up your deficiency and eventually come out with less equipment trusts outstanding in 1953, and under this schedule if you use all of the money representing the useful life of the equipment that disappears from the equipment, that represents new life in new equipment.

Q. Well, as I got the figure, taking your own testimony, if you took both your reserve and retirement fund and your additions and betterment fund, on all income up to $15,000,000, you would have a maximum of $10,700,000 available, and on the basis of past earnings it would be materially below that.

A. Based on the immediate past.

Q. Whereas your requirements, as estimated by the officers of the company, and subject to all the com-
3119 ments that you have made, aggregate $12,900,000, so that you would have a minimum of $2,200,000 and

more probably, something around $3,000,000 a year, either to be curtailed or to be financed in another way, is that not so?

A. If it was necessary.

Q. It would either be curtailed—

A. If it is proven that those estimated are the requirements that must be provided for, then on that basis they must either be curtailed or financed in some other manner.

Q. Now, you haven't talked this particular problem out with the operating officers, have you?

A. No, I cannot say that I have discussed that fully and at great length with the Officers, but I have gone through the statement of additions and betterments to road and equipment since 1921, together with retirals, together with salvage by years, and have checked that situation over and in my opinion, looking that situation over, the property will have sufficient funds—

Q. Well now—

A. —to take care of its needs.

Q. If the management should determine not to curtail these expenditures, that would mean an average over 3120 the next five years of something over $2,000,000, let's assume it was two and a half million dollars, that would be twelve and a half million dollars to be finan[illegible] otherwise than through income made available under the terms of the institutional investors plan. Of course, you have already testified that the bonds under your new first mortgage could not be sold at the present time, you would provide that—

A. That is true; on the other hand I would like to say that—

Q. And if you are going to provide a means of financing today to meet that situation, I mean if we were under a compulsion to have a reorganization plan which will provide a satisfactory medium of financing for such expenditures today, it would have to cut completely under all of your General Mortgage Bonds, or at least cut to a degree greater than your plan cuts, would it not, in order to be salable today?

A. Well, today I do not believe that the requirements are any greater than have been provided for in the plan with respect to new capital.

Q. Well, we are going to come to the question of new capital money in the reorganization in a minute.

A. I do not believe that for improvements and betterments—

3121 Q. But won't you answer my question?

A. —and replacement of equipment—

Q. Won't you answer my question.

A. That talking about today, whether you could sell these bonds and get new money, I do not think there is any necessity for new money today and I believe it would be a very unwise thing to do, no matter what the capital structure was right at the moment, to attempt to sell securities to get new money for this railroad, because it is up in excellent condition, it has during bankruptcy improved its equipment, it has improved its motive power, it has consistently improved its shops, its main shops, and it has built new shops and there today is no great imperative requirement for money that in my opinion would justify the sale of securities at the moment, at the present time, and as conditions exist.

Q. Well, when the time does come to meet these twelve and a half million dollars of expenditures, if they are not curtailed, then on today's present conditions there is no available medium of financing under your plan, is there?

A. Under conditions?

Q. As they now exist.

A. Prevailing today, and under conditions pre-

3122 vailing today—

Q. The conditions—

Mr. Burgess: Let the witness answer your question.

The Witness: They could not, in my opinion, with the capital as set up, dispose of additional securities and sell them, and in my opinion with conditions as they exist they should not attempt to do so, and the capital structure should not permit it.

Q. (By Mr. Swaine.) Now, Mr. Walker, will you be good enough to explain just how this reserve and retirement goes up, you set aside, do you contemplate that you shall set aside depreciation each month as it is charged to income?

A. Yes, sir.

Q. Set aside in a separate fund?

A. Yes, sir.

Q. Is it intended to be an annual fund?

A. To some extent it is annual, but not with respect to setting aside of the funds which flow from depreciation.

Q. Well now, how about your payments out, you said

that the payment out must be made in a certain order of priority.

A. Yes, sir.

3123 Q. Now, what is the period of time with respect to which that priority is applied; your fund seems to be set up on an annual basis, because you talk about it in each calendar year, and then you say that it shall be applied first to the payment of the principal of equipment obligations. Are we to understand that nothing can be paid out of this retirement fund in respect of a calendar year for any purpose other than equipment obligations until there has been built up in the fund an amount equal to the equipment obligations for that year?

A. That is correct.

Q. Therefore, in the early months of the year, if you have—your second thing is the payment in cash of an initial installment. Now, if in a given month you had cash in the fund, but no equipment obligation maturing that month, and your equipment obligation came at a quarterly date two months ahead, under this plan you would not be able to use that cash to buy equipment.

A. No, you would not.

Q. So that you could not buy any equipment from this fund until you had piled up into the fund in cash all your equipment obligations for the entire year.

A. All equipment obligations falling due, you 3124 must have the funds there to meet them.

Q. That tends to create idle cash, doesn't it?

A. Yes, but useful when needed.

Q. You have two dollars to do the work of one.

A. No, that is not so. It isn't two dollars to do the work of one.

Q. If the cash were there. On that basis then you have at the present time, on December 31, 1937, a $10,000 cash balance in the bank. That on the basis of two to one is one doing the work of—

A. $10,000,000 cash balance, it is one doing the work of $5,000,000.

Now, that is in the treasury, that is being held against the contingencies during the months—

Q. No—

A. —in which the earnings of the railroad are customarily low, comparatively speaking, and also in addition to that during the months when they are subject to fluctuations from weather conditions and otherwise.

Q. Well now this depreciation usually averages and is given in your estimate as about a half million dollars a month, isn't it?

A. That is correct.

Q. Assuming that you have equipment obligations
3125 that are going to mature in April and you set aside $500,000 in January and $500,000 in February and your maturity on April 1st is only $500,000, you could not use that million dollars in cash notwithstanding that you would probably have to buy equipment, notwithstanding that you would probably have during the month of March another half million dollars, could you?

A. Not if you had other equipment trusts maturing subsequent to the April 1st Trust.

Q. I am merely trying to find out how you expect to use it.

A. At the end of the year your balance would have been built up and thereafter you would go along and you would have your protection.

Q. Would you object to having the fund less rigid by entrusting to the management the determination of how it should be paid out as between equipment obligations and the purchase of equipment from time to time?

A. Reasonable easing up of that so as to still insure the conservation of funds to meet the principal of equipment trusts could not be seriously objected to, as I see it.

Q. Well now, you could not insure it, I concede it, you could not insure it unless you set it aside, but in the light of reasonable probability, don't you think the man-
3126 agement should have a little elasticity in the management of that fund?

A. Well, I should say that there should be some elasticity, and I think you have it here after you get through with your first period, when you get enough money so that you can insure payment of, meeting of the principal.

Q. Well, you wouldn't have much margin, would you, because with your fund, or your average maturity is $5,174,000, and this fund will average $6,000,000, so that leaves an average of $826,000, as I figure it left over, so that isn't going to build up very rapidly for the purchase of equipment, and presumably you will apply some of it to the purchase of equipment and therefore you would not on the basis of the figures for the next five years be able to build that fund up to the full extent, would you?

A. We feel that for the year 1938 there is $3,833,000 of equipment trust maturing.

Q. What is the depreciation for that year?

A. The depreciation for that year will be something over $5,000,000.

Q. So that when we get $6,000,000 as the average, and use this for the larger amount of equipment maturity—I mean if you are going to take the 1938 amount for
3127 one item you have got to take it for the other, haven't you?

A. Yes, but we are talking about, as I understood, what was going to happen to us immediately. As I said before, with respect to the application of some of this money to the cash payments on new equipment, if that cash payment—if the purchase of new equipment is necessary that might be modified somewhat so as to after reasonable assurance that the principal of equipment trusts coming due were to be met, could be loosened off a little bit.

Q. Now, let's come to this question as to the need of new money. Your plan contemplates that it shall be effective on July 1 of this year, does it not?

A. It does.

Q. The property had $10,000,000 cash on hand at the end of last year.

A. Yes, sir.

Q. Have you been advised as to what it has on hand today?

A. No, sir.

Q. Have you been advised that the cash is being depleted at a fairly substantial rate?

A. I should imagine that at this season of the year there will be some disturbance in the cash, yes, sir.

3128 Q. Did you discuss with either Mr. Scandrett or Mr. Sparrow the estimated amount on hand on July 1, of this year?

A. I cannot say that I did.

Q. Do you remember that at the meeting held on January 20th in the office of the New York Life Insurance Company, the Sub-Committee of the Board advised you that Mr. Sparrow's guess, and admittedly it is a guess, as to the cash on hand on July 1, was $3,000,000 and we suggested that there ought to be a provision for new money?

A. I recollect—

Q. At least a permissive provision.

A. I recollect there was a statement made to that effect and I also recollect that the suggestion was made by the Committee that there should be some permissive provision so that additional cash could be provided.

Q. Well, don't you think that if we are going to do a lot of guessing about what the condition is going to be that we ought to guess on the upside rather than the down side, with reference to having cash on hand, when the property comes out of the reorganization?

A. Well, I think if you will look over the record of the road, a $3,000,000 cash balance on hand at that time of the year is not something that would give any more
3129 concern, if that is all the cash they had, $3,000,000.

Q. Would you be content to see the property come out of reorganization then with only $3,000,000 of cash?

A. Depending upon what the conditions were on June 30th, 1938.

Q. Well, in the light of today's conditions, would you be content to see the property with $3,000,000 cash and your plan in effect?

A. It is not in effect today, it is not proposed to go into effect.

Q. I say, would you be content to see it in effect today with $3,000,000 of cash on hand.

A. No, because this is January, and January, and February and March are very poor months for revenue and income on the Milwaukee Road.

Q. Do you think it likely that the fixed charges under your plan will be earned in the year from July 1, 1937, to July 1, 1938?

A. No, I doubt it. But I think it is entirely within the realm of possibilities, as I see it, that from July 1, 1938 to July 1, 1939, the interest will be earned.

Mr. Burgess: Mr. Swaine is trying to develop the
3130 value of the stock that he wants issued in the case.

Mr. Swaine: Thanks, for explaining my dark purposes.

Q. (By Mr. Swaine.) Have you examined the amount of cash that the property has had on hand in the past?

A. Yes.

Q. And you are aware that at the end of 1930 they had about $30,000,000 of cash?

A. Well, I could not say what it was at the end of 1930, but I am also aware of the fact that in 1938 and 1929, they spent a tremendous amount of money on the

property, and they did the same thing in 1921, 1922, 1923, and 1924.

Q. Wouldn't you think it advisable to have a little reserve for the rainy day that Mr. Burgess' partner talks about in the rate case, or talked about the other day?

A. Yes, but I am putting it in the retirement and reserve fund where it can't be used for any purpose other than necessity.

Q. And the payment of equipment obligations.

A. If it is not used.

Q. And then the next purpose is the purchase of equipment?

A. That is the next purpose.

3131 Q. Well, we have exhausted it by now.

A. Oh, you think so. Then you have no hope of the future of this property, if that is the situation.

Q. No, I am hopeful, but I am talking about present conditions.

A. Well—

Q. I am trying to develop the question of whether it is not all hope, and whether we won't perhaps wait until we know whether there is a little better foundation for the hope, or if we are going to go ahead without waiting to see whether there is any foundation for the hope, whether we would not be wise to provide at least some umbrella in case our hopes were not fully realized.

A. Well, if the umbrella tempted us to go out in the rain, I think it would be a very poor asset.

Q. Now, you do provide in your plan, your ten millions of emergency fund to be used without any restrictions, you say they are to be in the treasury of the company.

A. We do not say without any restrictions.

Q. Your first ten million dollars.

A. Not without restrictions.

Q. Well, they don't have to be issued against additional capital.

A. No.

3132 Q. And they are free of the 1½ times coverage provision?

A. That is true. They are, at the discretion of the Board, to be used in the event of emergencies.

Q. You were advised, were you not, that a similar provision at the time of the 1928 reorganization was held ineffective by the Interstate Commerce Commission, that

the Commission held that the only securities which could be issued in the reorganization were securities to be issued against considerations then received and that as to any future sales by the carrier there must be a future consideration which could be capitalized under their rules?

A. I was advised something to that effect, but I came to the conclusion that the Commission would prefer to have $10,000,000 of bonds in the treasury which could be used in the case of emergency, rather than $10,000,000 worth of bonds outstanding in the hands of the public drawing interest.

Q. Well now—

A. And that—I am frank to admit, as we discussed the matter, that I was not in a position to state or determine just what would be the mechanics of bringing this about, but that this was what I believed would be a very desirable and proper provision to have in the mort-
3133 gage?

Q. Well, should there be any difficulty in connection with those bonds under the Commission's rules, would you have any objection to having the plan provide that an amount of bonds up to $10,000,000 might be sold to provide such working capital as the circumstances existing at the time of reorganization might make necessary?

A. Why—

Q. Not a mandatory provision for the sale of $10,000,000 willy-nilly, but a provision authorizing the sale in the reorganization of $10,000,000 of bonds or new money.

A. If it is determined at the time of reorganization that there is not sufficient funds to reorganize the property and leave it with sufficient working capital available at that time.

Q. Should not the plan recognize that possibility?

A. Well, if the Commission so found, subject to the Commission's finding of the necessity for that additional capital, I can see where that might be advisable.

Q. You would not oppose that kind of a modification?

A. I can see where that might be a provision that might add to the soundness of the Plan.

Q. And in view of the fact that the Series A Bonds
3134 that you contemplate, with their long maturity, and their 4 per cent rate, might not be capable of being sold at par, do you not think there ought to be a discretion

in the reorganization committee subject to the approval of the Commission, of course, to reduce the maturity of those bonds, and increase the rate so as to insure the provision of such amount of money as may be necessary?

A. Not increase the rate.

Q. That is, you would rather sell a 4 per cent bond at a discount than to sell a 5 per cent bond?

A. There might be shorter maturity, depending upon the amount that were to be sold, and in that event then those bonds so sold, in my opinion, should carry a proper fund for their retirement, so that the Series A First Mortgage Bonds within a very reasonable time are restored to their present position, in every respect.

Q. You would have no objection to having the permissive provisions subject to those restrictions, included in your plan?

A. Personally, as I have said, a permissive provision of that kind, conditioned as I have stated, upon the various matters that I have stated.

Q. Don't you think it would be wise, as well as not 3135 objectionable?

A. I have stated that personally, not having an opportunity in any way to determine what the committee would feel about it, I said personally I thought it might improve the plan.

Mr. Swaine: This is a convenient stopping point, at the subject matter of coverage, Mr. Examiner.

Director Sweet: We will be in recess until two o'clock.

(Whereupon, at 12:30 o'clock p. m. an adjournment was taken until two o'clock p. m. of the same day.)

3136 Afternoon Session.

2 o'clock p. m.

Director Sweet: Proceed, Mr. Swaine.

FREDERICK W. WALKER, testified further as follows:

Cross-Examination (Concluded).

Mr. Swaine: Mr. Walker, on your direct you testified that you believed there should be a conservative ratio between the fixed interest debt and total capitalization, and between the total debt and total capitalization, and that your plan met that test by having a ratio, as I remember your testimony, of 26 per cent on fixed interest debt and 43 per cent on total debt, are those the right figures?

A. I will have to check that.

Q. I think those were the figures you gave.

A. Approximately that.

Q. At what point would you think conservatism would desire, that is, at what point do you think it would be inadvisable to stop off fixed, or fixed debt in comparison with your total capital and your total debt in comparison with your total capital?

A. Well, as to the stopping of that, my own idea is that the total debt should be somewhere between 50 and 60 per cent of the capital structure, if that can be
3137 maintained at around that point, not in excess of that.

Q. So that in your opinion if the total debt grew so that it was beyond 60 per cent your capital structure would at least be in the way of being impaired and becoming unsound?

A. In an industry that is not expanding and growing rapidly and continuously, I would say that would be the case.

Q. And what part of your total capital structure do you think could conservatively, or put it the other way, what is the maximum percentage of fixed debt that you think would be conservative?

A. Well, maximum as I say—of debt, fixed debt?

Q. The 60 was the total fixed and contingent.

A. That would depend when you come to fixed debt, as between total debt, that would depend upon the character of the business and the assurance of fairly constant revenues, that is, no wide fluctuations in revenues in different years. For example, in public utilities where generally speaking the debt is fixed interest, depending upon the utility and its location, the character of its physical property, we go to 70 or even 75 per cent of the debt.

Q. I am not asking about some other kind of util-
3138 ity, let's talk about the St. Paul. In the light of the St. Paul's earning record and present conditions, what would you think, what percentage would you think was the maximum of conservative fixed debt?

A. Well, I would not want to see the debt go up much above 50 per cent.

Q. That is, total debt, I am now talking about fixed debt.

A. I would not want the fixed charge debt to go up to such an extent that it would be covered by about, the interest covered by about two times.

Q. Therefore, if you had your, what you have called the average normal year of fifteen millions of earnings, you think that conservatism would make it wise to have the fixed debt not over seven and a half million?

A. I would think that that would be a very desirable thing.

Q. And your present plan has $6,556,000, hasn't it?

A. That is correct.

Q. So that in the absence of any limitation you have got only, you have got less than a million dollars of margin between what you are starting with and what you think exceeds the bounds of conservatism?

A. If the earnings did not exceed—

Q. Fifteen million dollars.

3139 A. —fifteen million dollars, but on the other hand, in the fifteen million dollars there is provided in determining the coverage of the fixed interest and as to its margin during that period there would be in additional funds going back into the property, in the committee's plan, rather than capitalized.

Q. Well, the Debtor agrees with you that they should not be capitalized except possibly in common stock.

A. Well, we disagree with the Debtor that they should be capitalized even in common stock.

Q. All right, let's don't capitalize it at all, then, so you are not piling up your fixed, and that, it seems to me, results in reducing rather than increasing your 35 per cent ratio, wouldn't it?

A. That would—I didn't say 35 per cent.

Q. No, you are quite right.

A. 35 per cent ratio.

Q. Strike that question, Mr. Reporter.

A. I didn't make that statement.

Q. If you do not capitalize even in common stock the capital expenditures which you make out of earnings then your 60 per cent of total debt would be a smaller figure obviously than it would be if those expenditures had been capitalized?

A. That is correct.

3140 Q. So that your answers lead to an even more conservative view of what your debt would be than that provision which you criticized in the Debtor's modification?

A. I have not criticized that yet, because I have not heard about it.

Q. You just now said you disagreed with the provision for capitalizing it.

A. Without a provision—

Q. For permitting capitalization in common stock.

A. Oh, yes, I disagree with that, decidedly.

Q. Therefore when you say—

A. That is, I disagree with capitalizing it in common stock, or in any other way capitalizing any expenditures that would come from the improvement and betterment fund and the retirement fund, as we have shown them, as they are shown in the committee's plan to any greater extent than they might be capitalized under this plan.

Q. Now, all I want to get at is having capitalized those expenditures keeps your 60 per cent at a lower amount than you capitalize them?

A. That is true.

Q. That is an obvious mathematical computation?

A. That is true.

Q. Now, has your plan imposed any limitations on the extent to which fixed debt can be built up?

3141 A. Yes, it has.

Q. In what way?

A. It imposes it on the basis, first, that it can only be built up to 75 per cent of net additions and betterments.

Q. Yes.

A. It also imposes the limitation that the additional bonds may not be issued unless the charges, fixed interest charges or the charges on the bonds to be issued and all debt standing on a parity with those bonds or prior thereto, is earned one and a half times.

Q. Well, if you have fifteen millions of earnings that would permit ten million dollars of fixed charges, wouldn't it, on a one and one-half times coverage?

A. That is right.

Q. You just said, didn't you, that on fifteen millions you thought you exceeded the bounds of conservatism when you passed seven and a half million?

A. I said that I believed the lowest really conservative basis, in my opinion, would be coverage twice, but there are others that feel that that is rather too heavy a coverage, and the consensus of the opinion of the committee was, in connection with the plan, that it should be made at one and a half percent, that two percent would be too rigid.

3142 Mr. Burgess: One and a half times.

The Witness: One and a half times, and that twice would be too rigid. My own feeling is that twice earnings for those bonds would be a proper figure.

Q. Then you think your plan errs on the side of lack of conservatism?

A. That is not as conservative as I personally would make it.

Q. Well, now, let's take the plan as it is on the one and one-half times coverage and your assumed average normal year of fifteen million, if it runs ten million dollars, then assuming a 4 per cent average that would mean $250,000,000 of fixed charge obligations, would it not?

A. That is true.

Q. And you are starting with how much, $162,000,000?

A. That is correct.

Q. So you have a margin of $1.63, really we have a margin of about $87,000,000 there for which there is no check except the provision that only 75 per cent of your capital expenditures should be capitalized?

A. That is true.

Q. Mr. Walker, if it is lacking in conservatism to have more than 60 per cent of your total capital, past and pres-

ent and future in debt, why isn't it lack of conserva-
3143 tism to have 75 per cent in respect of current ex-
penditures, why should not the same figure be applied,
60?

A. The same figure be applied?

Q. Yes.

A. In the issuing of additional bonds?

Q. Yes.

A. Because of the fact that the additional bonds are not to be issued for all of the improvements and betterments. We have a compulsory provision, this plan provides for a compulsory additions and betterments fund, if earned. And that being the situation, it is not a flat 75 per cent for all improvements and betterments, and in addition to that the improvements and betterments that come in from the funds derived from this additions and betterments fund are not capitalized.

Q. Yes, but you do permit capitalization of 75 per cent, your additions and betterments fund is intended to permit to provide for 75 per cent, and you do contemplate the issuance of bonds or permit the issuance of bonds to 75 per cent of the expenditures, don't you?

A. That is true, provided the interest is earned one and a half times.

Q. Won't the tendency of that provision be that in times of high earnings the management particularly
3144 if it is interested in the cost will be anxious to issue bonds up to the limit rather than equity securities?

A. That might possibly be the case, unless there was a cut-off provision in the mortgage against carrying ahead improvements and betterments balances.

Q. The cost of new money under bonds of course would be less than the cost of new money under even preferred stock, wouldn't it?

A. That is true.

Q. At any time?

A. That is true.

Q. And the higher your earnings the more clearly that becomes true, the better your grade is the cheaper your available new money on bonds?

A. And on stock also.

Q. Now, did you consider the advisability of putting into your plan any provision designed to maintain the capital structure within a conservative basis by encourag-

ing the issue of equity securities when equity securities could be sold on a proper basis?

A. There were some suggestions made by the sub-committee of the debtor that met with our committee along those lines.

Q. Have you given those suggestions thought?

A. I have.

3145 Q. Will you please state to the Commission what your opinion of the advisability of such provision is?

A. The provisions as drafted, it seemed to me, did not afford the measure of protection that is afforded by the provisions in the Committee's plan. And also it seemed to me that the rigidity was such that, the rigidity of these provisions, that they might be even more disadvantageous to the management in the handling of its property than the provisions in the Committee's plan. It is my understanding, in connection with these provisions that were brought to the attention of our committee at this conference, that they were offered in substitution of the provisions in the Committee's plan under which the issuing of additional bonds was dependent upon the provision as to earnings, as to earning of the interest one and a half times, am I correct?

Q. That is a correct assumption, and you understood that they were only in substitution for that provision, did you?

A. They were only in substitution for that provision.

Q. And only that way, under the 75 per cent?

A. The 75 per cent.

Q. So that all we are dealing with now is the question of whether a sound capital structure will best be

3146 preserved by having no limitation upon the issue of bonds except one and a half times coverage or by a combination of provisions that the fixed charges shall not exceed some agreed conservative maximum and the total debt some agreed conservative maximum.

A. Which the Commission—

Q. Plus a provision—

The Witness: Excuse me.

Q. Plus a provision preventing the issue of bonds at a time when, paraphrasing the Debtor's modifications equity securities can be sold on a 6 per cent basis, costing not to exceed 6 per cent. Now, will you state why you think such provisions are not in the interest, the substitute provisions are not in the interest of conservative capital-

ization or are less conservative than the provisions of the Committee's plan for which they are offered as a substitute?

A. The substitute provisions, as I understand them, the first provision is as follows, and I will paraphrase this rather long text, and give the substance of it as I understand it:

That no new first mortgage bonds shall be issued if the issuing of these additional first mortgage bonds will result
3147 in bonds on a parity with the first mortgage bonds or debt on a parity or prior in lien to the first mortgage bonds, exceeding 75 per cent of the capital structure. And that in no event shall the first mortgage bonds and debt on a parity or prior to the first mortgage, and debt on a parity or prior to the general mortgage combined exceed 55 per cent of the capital structure. If such a situation exists no first mortgage bonds can be issued under any circumstances. They stop right there, it doesn't make any difference what the necessity of the case is, if you have reached that point you can't issue any fixed interest debt, and if the total is 55 per cent you can't issue any junior to either.

So that I believe is too rigid, and that the emergency fund bonds, as provided in the Committee's plan, namely, ten million in the emergency fund of first mortgage bonds, to be used in the event of emergency and the replacement at once in the emergency fund of another ten million of bonds without the earnings limitation of one and one-half times, against net balances for additions and betterments, if there are such net balances, is a much safer provision and sufficiently conservative and desirable, at the same time sufficiently conservative and desirable, than the provision
3148 which is proposed as a substitute, or partial substitute, by the Debtor for the limitation of one and a half times earnings included in the Committee's plan.

Now, going along with this provision—

Q. I wish you would discuss all three together, because they are interlocked.

A. I am coming, I am taking them right through, but as I understand this first provision as drafted and as appearing here, there is a positive block against the issuing of any additional debt regardless of the necessities, if the debt is 55 per cent of the capital structure.

Q. Well, do you think, let us assume, because we are now for the first time trying to discuss these problems together.

A. No we are not, I disagree with you there, I discussed these problems at this conference, and the draft in that respect was substantially as it is now.

Q. Well, suppose—

A. And I would like to finish my discussion of these provisions which work in together.

Q. I want you to, go ahead.

A. I want to finish my discussion of these provisions which work in together without going through any modification of a particular one of these substitutions which you may have in mind, which may affect what there is here in this draft of modifications, which is the
3149 final draft that was delivered to us as the modifications which the Debtor proposes.

Q. Well, Mr. Walker, we are not determined about this, and we have no pride of authorship in them, we are trying to find the best way to meet this question, and I will ask you then to assume in your discussion that you have in that modification the same kind of a ten million dollar emergency provision that you had, let's use the same kind of an emergency provision that you have got, and we have an emergency provision in the next one, so let's put the emergency provision in here; would you object to having safeguards in your authorized issue within the limits of agreed conservative maximums, and we have no pride of whether it is 55 per cent or 60 per cent.

A. I would say that the suggestion which you have made will improve that provision, but before answering the remainder of the question I would like to bring out the facts in connection with these other—

Q. Well—

A. —provisions.

Q. Haven't you—

A. Which go—

Q. Yes.

A. Which go to the determination of whether or
3150 not these limitations, that is, the limitations with respect to percentages of debt to capital structure are more desirable limitations from a practical standpoint, realizing as I do that we are all interested in obtaining a sound capital structure here and one which does not restrict the management in a proper operation of the property.

Q. Now, before you go on to the next one, if you apply the 35 per cent restriction which the Debtor suggests to

the total capitalization I think you will have about $224,000,000 of available fixed debt, would you not?

A. No.

Q. If you took the 35 per cent?

A. No, you would have $268,000,000 of available fixed debt that you have unrestricted, without any restrictions as to earnings at all, your sole restriction being 75 per cent.

Q. Well, now, wait a minute.

A. Just a minute—in the cost of additions and betterments. You have the right under the 35 per cent of the capital structure limitation and the 55 per cent of total debt, the right to issue $105,000,000 of additional first mortgage bonds.

Q. I think your figures are wrong.

A. I think they are right.

3151 Q. Well, now, wait a minute. $640,000,000 is the total, isn't it?

A. $660,000,000 is the total capitalization at the present time.

Q. I am taking your plan.

A. Well, I am taking your plan. These are the suggestions that you make.

Q. All right.

A. And the capital structure that you suggest.

Q. All right. Then take it. I won't quarrel with you about that, let's take 35 per cent of $660,000,000, and how much is it?

A. That isn't the capital structure after you issue these bonds, because the provision in here provides that the total amount of capital structure will include the new bonds to be issued.

Q. That is right.

A. All right. So when you take 35 per cent for the fixed interest-bearing debt and income debt down through the capital structure you will find that the total capitalization will be with this 35 per cent, instead of $660,000,000 it is $765,777,000.

Q. How do you work that out?

A. Well—

Q. If you start with $660,000,000, if that is your
3152 figure, and say that your permissible maximum is 35 per cent of fixed charges, you don't get any figure like $700,000, do you?

A. $765,000,000 will be your capitalization.

Q. That then represents—

A. The 35 per cent that you may use isn't 35 per cent of the capitalization before you issue the bonds, but it is 35 per cent of the capitalization after the bonds have been issued.

Q. And that—

A. If that calculation is made.

Q. That is right.

A. You will find that here without any limitations under these provisions as to earnings, the only limitation being the 75 per cent, $105,000,000 of these bonds may be issued.

Q. Yes.

A. Of first mortgage bonds, and under the earnings limitation, conservative earnings limitation, etc., and that you were mentioning a few minutes ago, you stated that under the Committee's plan $87,000,000 could be issued based on the one and a half times earnings.

Q. But if you can issue only your 35 per cent in fixed charge obligations, that means that the remaining
3153 15 per cent of that added capital has been plowed back, either out of earnings or by the capitalization to equity securities, does it not?

A. No, it does not, because there may not be any additional securities issued over and above the $105,000,000 that you issue to reach your 35 per cent, and if you are going on up to the 55 per cent so that you can issue some other bonds instead of fixed interest-bearing obligations then the limitation which you have prescribed in your suggested modifications will permit of the issue of about $145,000,000 of debt without any consideration to earnings.

Q. Well, I thought your objection to these provisions was that they impose too low a restriction on the management and there would not be enough bonds, you said a minute ago that it was too rigid on the management and we were going to come to a time when we could not issue bonds.

A. That isn't the situation, I said this first restriction, the way it was provided in here.

Q. That is right.

A. That if you did get to this condition, in other words, when you got to 55 per cent of debt in your capital structure, or before you got to 55 per cent, if you got to 35 per cent of fixed interest debt and conditions were such
3154 that you could not issue any or dispose of or sell any contingent interest debt or other securities you are

frozen right there under this provision. That is what I said was unduly restrictive of the management.

Q. All right. Now coming to your next provision and see what would have been happening during that period in respect of the issue of equity securities in your capitalization.

Mr. Burgess: Our next or your next?

Mr. Swaine: The next one in the three particular modifications.

A. The only one in the three modifications suggested by the Debtor provides as follows:

"The first mortgage will contain a covenant substantially to the effect that no first mortgage bonds other than those to be issued under the plan will be sold or pledged if (a) the average market price of the outstanding General Mortgage Bonds during the last twelve calendar months preceding such sale, and during the last calendar month preceding such sale, shall have been such as to produce a yield to maturity of less than 5 per cent or (b) all cumulative accrued dividends on outstanding Preferred Stock shall have been paid, full dividends shall have been regularly paid on all outstanding preferred stock 3155 during the last twelve calendar months preceding such sale or pledge, and the average market price of the outstanding preferred stock during said last twelve months, and during the last calendar month preceding such sale or pledge, shall have been such as to show a current dividend return (disregarding any payments made on account of accumulations) of less than 60 per cent per annum;" and then we go along with the provision in connection with the common stock.

Q. But it doesn't have to be sold at less than $50 a share. Now, putting it very briefly, that is a provision that you shall not issue fixed, that you may not finance contingent interest debt on lower than 5 per cent cost or buy stock at a lower than 6 per cent cost.

A. Well, that may be the intent of it, but I do not think that is what it says, and I do not believe that is the way it will work out.

Q. Assuming that is the—

A. Because you state here "the average market price of outstanding general mortgage bonds during an 18 months period will be such", and during the month preceding will be such, and I do not believe that the average price of those bonds and the yield based on that average

price is any evidence that a substantial block of gen-
3156 eral mortgage bonds or a substantial block of pre-
ferred stock in financing, for the purposes of financ-
ing, can be sold.

Q. Well, we did not have the benefit of this kind of a discussion, I didn't have it before I drafted that provision, and this is helpful. Now assuming that the intent is to provide—and that language can be found to express the intent that you should not issue fixed charge obligations if you can in fact sell contingent obligations on a better than, we will say, 5 per cent cost, or you can in fact sell stock on a less than 6 per cent cost, do you not think it advisable to have such covenants in your mortgage in order to encourage building up the base, isn't that in your interest as a bondholder?

A. That might be a provision that would add to the security of the bondholders, but not as a substitute for the earnings provision. I believe that the limitation as to the issuing of bonds, with respect to the times interest earned, is an essential protection, with the flexibility that has been given to it in the plan proposed by the Committee.

Q. Is your times earnings covered, Mr. Walker—I am asking this for information, because I do not know from reading your plan, is that a limitation on the authentication of the bonds by the trustee or is it a limitation
3157 upon the company's right to sell or pledge the bonds after they have been taken down?

A. It will be a limitation on the right of the trustee to authenticate the bonds, would be my judgment as to what it should be.

Q. And I rather thought and I believe it is so expressed, I rather thought that was the intent.

A. Yes, sir.

Q. We didn't get a chance to talk that out either. Now isn't the real test of whether you are helping or hurting the capitalization to be applied at the time the bonds are sold or pledged rather than the time that they are taken down from the trustee, you allow them to be taken down over a three year period, do you not?

A. I do not recollect that there was a limitation on that as to the three year period.

Q. Well, if there isn't a limitation then the bonds can be taken down from time to time against the 75 per cent so long as there is the one and a half times coverage?

A. That is true.

Q. And put in the treasury of the company?

A. That would be true.

Q. And then you come into a period later on when you issue bonds and you can issue them irrespective
3158 under your then coverage?

A. Well, you can sell them.

Q. Well, you might pledge them.

A. Well, you might dispose of them instead of issuing them.

Q. Wasn't one of the troubles with a great many railroads just prior to the bankruptcy of several of them the fact that they pledged an excessive amount of bonds for the loans which they got and watered the security of the bondholders?

A. Very true, I agree with you absolutely.

Q. Therefore should not, as a matter of sound drafting of these mortgages, should not these restrictions apply to the time of sale and pledge and not to the time of authentication?

A. I would say that in connection with the pledge the suggested modifications that the Debtor has included, namely, that there should be a limit fixed on the amount of bonds par value that can be pledged for a loan, relatively, proportion of the par value of the securities to the face of the loan, I believe that is a desirable provision. In my mind, however, I wonder, and that is one of the things that I personally have not been able to reach any conclusion on, as to whether the ratio which is shown as the
3159 Debtor's suggested modification is the ratio that should be finally applied.

Q. Well, what is your suggestion, that is a ratio of, that you should not pledge more than 150 per cent of bonds against any obligation.

Director Sweet: Face amount of bonds against face amount of debt.

Mr. Swaine: That is right.

Director Sweet: No reference to the market value of the securities.

Mr. Swaine: That is right. That developed in our discussion of two hours that we had, that was one of the things that the institutional investors felt had proven to be defective in past financing, that is, that bonds were pledged for too low amounts of money received, and thus the security of outstanding bonds was watered. Reference

was made to such situations as the Chicago & North Western.

The Witness: As I stated, I have not been able to reach a conclusion as to what should be the limitation, whether 150 per cent is proper or whether it should be possibly somewhat higher than 150 per cent.

Q. (By Mr. Swaine.) But the principle of it, subject to further discussion, you think is not an objectionable principle?

3160 A. The principle I personally feel has a great deal of merit.

Q. Well,—

A. And I personally feel is a desirable principle to include in the mortgage.

Q. Well, then, don't we really get down to this, that assuming we can draw this language, as we did in 1935, by sitting down together and being sure that we are expressing our right intent, don't we agree with the intent in those three provisions, that that intent is a sound intent and that it would be wise to incorporate them, although we may disagree as to whether they are a proper substitution for the one and a half times coverage?

A. Well, I do not think that they are if there is no earnings provision.

Q. I see, we did disagree about that.

A. Well—

Q. Well, let's assume that we had them both, how would you like that?

A. Well, if we had them both in here I can't see where with the both of them in and then with the 35 and 55 limitation rendered innocuous in the event of necessity to issue some bonds in an emergency, which this 35 and 55 suggestion that there should be no—under those condi-

3161 tions, under no conditions could you issue any additional bonds, fixed interest bonds if the debt was 35 per cent of the capital structure—

Q. No. I should say we will apply it, we will take your ten million dollar emergency, and you had only one restriction, your one and a half times earnings.

A. Yes.

Q. And you had a ten million dollar emergency, and that restriction, I am suggesting now that we take not only the restriction that you have provided but the restrictions which the Debtor thinks are essential to the maintenance of a sound capital structure and save all of the restrictions

to the ten million dollar emergency, that is when we add to your restrictions other restrictions, we also had your emergency clause apply, do you think that that would make for a sound capital structure and the preservation of a sound capital structure?

A. You mean that except in case of emergency—.

Q. That is right.

A. —the one and a half times earnings would apply.

Q. All the restrictions would apply.

A. Then let me get it clearly in my mind: The one and a half times earnings restriction would apply and then the 35 per cent fixed interest debt would apply as a maximum, the combined maximum 55 per cent for debt—

3162 Q. 60 per cent if you say so, whatever is conservative.

A. Would apply, and that then in the event that the sale of these junior bonds could be made on a basis of income to be agreed upon that then no first mortgage could be issued and juniors must be issued; on the other hand if preferred stock could be sold, could be sold upon basis to be agreed upon, then neither any first or general mortgage bonds could be issued, but preferred stock was to be sold; and then again if common stock could be sold upon an income or dividend basis to be agreed upon none of the senior securities would be sold; would I feel that that was—

Q. We don't go quite that far, we don't ask for a distinction between preferred stock and common stock.

A. I desire to correct my statement, it stopped at the sale of preferred stock.

Q. All right.

A. I think if conditions were such that by reason of those inclusions in there that the junior securities could be sold, that it would help to hold the capital structure in sound and conservative condition.

Q. You were familiar with the Frisco's financing back in 1928 and 1929, weren't you?

A. No, I was not. Fortunately we had no bonds in

3163 the Frisco.

Q. Do you understand, Mr. Walker, and again I am not sure what your plan means, could you under your plan issue additional bonds to buy an interest in a union terminal?

A. I would think so.

Q. Whereabouts?

A. At least the mortgage should so provide, when you

begin to get into the details of drafting the different parts of the mortgage.

Q. Well, my point on that is that the Debtor's modification provides for the issuing of mortgage bonds against the capital expenditures, after taking out all retirements chargeable under Interstate Commerce Commission rules to capital account, and you reject that modification and specify certain kinds of capital expenditures that could be bonded, and I am unable to find in your plan—and again had no chance to talk to you about it—any provision under which the reorganized debtor could buy an interest in a union terminal, or in a jointly owned bridge, or in a ferry company. I say that merely for the purpose of illustration, and ask you if you would not be willing to have this provision so modified as to permit the issue of bonds against all capital expenditures as defined by the Interstate
3164 Commerce Commission, subject, of course, to the restrictions that the basis is to be the net and not the gross.

A. And subject to such restrictions—

Q. Oh, yes, I am dealing only with this one question of the character of the expenditures.

A. Yes.

Q. Of course, all of the other conditions have got to be agreed on too, and if we can sit down maybe we could.

A. In other words, I am firmly of the belief that the reorganized company should not have its hands tied in the proper conduct of its business.

Q. Well, now, let's come to another one of the provisions in your mortgage and see if we can agree upon some relaxation. You provide that if you issue first mortgage bonds against equipment you have to issue a separate series of bonds against that equipment having a 15 year maturity, do you not?

A. Yes, sir.

Q. Now, there are times when it is in the Debtor's interest to issue long term bonds, is it not, the market is better for long term bonds at times?

A. That is true.

Q. Could there be any objection to a modification providing that when you issue bonds against equipment they can be of any maturity provided a sinking fund is
3165 required to be set up which would retire an equivalent amount of bonds within the 15-year period.

A. That would substantially comply with the purpose of this limitation.

Q. Wouldn't it fully comply, your idea is to reduce the debt by that amount?

A. I think it would, the retirement being to reduce the amount of the debt, or the debt is actually put up against equipment, and amortize that debt.

Q. That is right.

A. And to retire the securities within the life of the equipment, not to exceed 15 years.

Q. And thus to permit the reorganized debtor to issue the kind of securities which was best in the light of market conditions.

A. I can't see any objection to that modification.

Director Sweet: There might be considerations where bonds might be issued at rates better than equipment obligations for the purchase of equipment.

The Witness: This situation that in addition to the security of the lien upon equipment, the bonds would also have a lien upon the property of the company, and that there might be conditions under which that type of financing would be more advantageous. The limitation with respect to the sinking fund if the bonds are issued, was
3166 occasioned by the fact that in several railroads we have found that long time bonds have been issued against equipment and that equipment has passed out of existence and the bonds are still outstanding. There is a particularly aggravated case in connection with the Monon, in which equipment, after equipment trusts were paid off, the equipment was used as the basis for issuing bonds up, I think, to 60 per cent of the cost new and some four million dollars of bonds were issued against that equipment that was 15 years old, and has diluted and represented a very substantial amount of junior bonds now outstanding, and the underlying bonds have the first lien upon such equipment as is still in existence, and for that $4,000,000 of bonds there is no security.

Director Sweet: This sees to it that these long term bonds cannot be issued in connection with the acquisition of perishable property.

The Witness: Yes, sir.

Director Sweet: But what led you to believe that it might be better to issue bonds that could be retired say in 15 years by the acquisition of new equipment, in preference to the issue of customary equipment obligations.

The Witness: There was no controlling reason for
3167 that. The provision could be eliminated, if objectionable; but it seemed to us and seemed to me that it gave a little wider discretion to the mortgagor company, the directors of the mortgagor company, over a period of years in the future while these mortgages were being paid off.

Q. (By Mr. Swaine.) Might it not also improve the security of the mortgage itself to have this equipment right under it?

A. The financing measure in this method, or have this method available for financing if they desire to use it.

Director Sweet: In very recent years equipment obligations have been issued at much lower rate to the carriers than bonds, haven't they?

The Witness: That is true, they stand in a higher position with respect to their investment quality, generally speaking, than railroad bonds.

Director Sweet: And the money that railroads have secured through the issue of equipment obligations has cost the carriers much less, hasn't it?

The Witness: That is true.

Director Sweet: Than money secured from the issue of bonds.

The Witness: At the present time under the Commit-
tee's plan the only vehicle of financing that could be
3168 used, based on present earnings, would be equipment trusts for replacement of equipment.

Mr. Swaine: Mr. Director, there is no suggestion that this be made a mandatory provision in either plan.

Director Sweet: I understand.

Mr. Swaine: Merely permissive. I want to make the suggestion that it might be better for mortgage bondholders to have the equipment put in under the mortgage. The fact that in recent years we have been able to finance better equipment obligations does not establish that it may not be the converse in the future years, and our point is only that there ought to be provisions here which do not impair the Debtor's ability to take advantage of whatever is the most favorable method at the time.

Director Sweet: Well, the question that occurred to me in that connection was that unless it could be shown that there is some probable advantage in arranging for the issuing of bonds to acquire equipment, there is no use of

making your scheme any more complicated and difficult than necessary.

The Witness: There was this question taken into consideration and discussed: The question has been raised as to whether or not equipment trusts are conditional sales or chattel mortgages. That has not been tried out,
3169 and that the amendment of Section 77 in which it provided that property sold under a conditional sale agreement, the trustee of the mortgage was not stayed from exercising the remedies, and that has placed the equipment trusts in a more advantageous position so long as they are considered and held to be conditional sale agreements or leases, as against chattel mortgages. Counsel for our company went into that question and his opinion as given to me verbally in our discussion of this question was that there was doubt, that it was not a dead open and shut matter. Now, that was one thing in connection with this, although it was not wholly controlling, and I do not consider that provision in the Committee's plan as of vital importance.

Mr. Burgess: Well, there is a very definite possibility, though, is there not, that these equipment trusts might through a change in practice or a change in law lose their present investment standing? They have had the best investment standing probably since the amendment of Section 77 that they have ever had, relatively?

The Witness: That is our belief, that is the belief of our company and my belief.

Director Sweet: Another uncertainty we have to deal with is the uncertainty of the law, isn't it?

3170 Mr. Burgess: Quite, and also the uncertainty of the judgment of the investment market in the future.

Mr. Swaine: I think this discussion has developed agreement between the Debtor and acceptance, I take it, by the institutional investors of that modification of their plan.

The Witness: I wish to say that I am not in a position in connection with these suggested modifications—

Mr. Swaine: All right.

The Witness: —to speak for the—

Mr. Swaine: All right, I understand.

The Witness: —institutional investors.

Mr. Swaine: I understand that.

Q. (By Mr. Swaine.) Now, there is another provision in your plan that the Debtor's officers and counsel do not quite understand, that ties into your mortgage provision.

In connection with your retirement fund, and in connection also with your additions and betterments fund you use the expression that you can use these moneys to pay 25 per cent of the cost of improvements or additions and betterments which are to be funded into bonds for the remaining 75 per cent of such cost before the end of the calendar year next succeeding—

A. Yes.

Q. —next succeeding the date of acquisition of such
3171 improvements or betterments.

A. Yes.

Q. Now, how can you tell, when you make an expenditure, whether you are going to fund it or not within the next year?

A. Well, if you are not going to fund it—

Q. Well, how do you know whether—

A. Within the next year—

Q. Within the next year.

A. —and you can't tell whether you are going to fund it within the next year, you will have paid for it and if you have paid for it then the money that is in the additions and betterments fund that has not been appropriated would go over into the reserve and retirement fund and that is the fundamental difference, one fundamental difference, between the reserve and retirement fund in the Committee's plan and the so-called reserve and retirement fund in the Debtor's modifications to the Committee's plan.

Q. Well, now—

A. Which in effect is merely a depreciation fund, it is not segregated except as to—segregated for the uses of the replacement of equipment, and under the provision in the suggested modification can be used before we come down
to anything in the way of a reserve in the fund for
3172 additions and betterments. In other words, any other capital expenditures for which first mortgage bonds might be issued.

Q. Now, Mr. Walker, can we get back to my question: How do you know when you make a capital expenditure whether you can fund it within the next year, you don't, do you?

A. No, not necessarily.

Q. And when you tie with this kind of a provision, you have got to earmark every capital expenditure?

A. To what extent?

Q. You have got to earmark it because it says you can

pay 25 per cent of the cost out of this fund for a betterment which is to be funded for the remaining 75 per cent before the end of the next calendar year succeeding the date of such acquisition and of course such acquisition varies every day in the calendar year of such improvement or betterment. Now, the thing that we are puzzled about is how on earth we could ever keep the accounts to meet that provision because of our right to pay out that 25 per cent apparently depends upon some event that might or might not happen within the next year.

A. Yes.

Q. And I wondered if you would be willing to have 3173 that modified to permit the use of that fund for 25 per cent of the net additions and betterments in general without attempting to earmark the day by day additions and betterments, as we have suggested in our modification, on just that one point, not the other things, maybe you ought to modify our provisions otherwise, but why shouldn't we be permitted to pay out 25 per cent of our net up to any given time irrespective of whether we are going to be able to refund them within a year after the time when we do a particular job.

A. Well, there might be some merit to the wording, within some limitations, but—

Q. Well, don't you think it would be—

A. —the purpose is that at the end of each yearly period unappropriated balances in the additions and betterments fund should go over into the retirement fund and then under the provisions of the retirement fund reserve, a retirement fund which can be used after the payment of the principal of equipment trust obligations, payment in cash of not less than 25 per cent of the cost of new equipment, if purchased under equipment trusts, or by the issue of bonds.

Q. Well, now, you are getting off on a different point. I am trying to keep, your Honor, if Mr. Walker will let me, to just this expression, which occurs several 3174 times in the plan, and I ask you, Mr. Walker, if you don't think that we ought to sit down and try to get away from the apparent tying of this thing down to two things, the specific item for which the expenditure is made, and to find expression having to do with the intent, if we can, when we make the expenditure.

A. I see.

Q. Don't you think it would be profitable to sit down and try to work it out?

A. I think it would be profitable when we come to draft the equipment provisions in the mortgage to try to work out provisions of that character.

Q. But this is a specific element in the plan, a specific limitation, and if this is a specific thing that is required then we will be tied to this, and I think you have answered my question satisfactorily.

Now, your present general mortgage bonds mature when?

A. Which bonds?

Q. General mortgage bonds.

A. Oh, you mean your—

Q. Your first general mortgage bonds.

A. Outstanding?

Q. Yes.

A. They mature, I think, in 1989, as I recollect it.

3175 Q. Yes. Now your new first mortgage bonds are provided to mature in 1968, is that not right?

A. That is correct.

Q. Now, why do you feel or why did you feel that it was necessary to accelerate the maturity of the outstanding bonds by something over twenty years in this reorganization plan?

A. It gives them a better market value, in my opinion, makes them more valuable.

Q. That might have been something of a compensation for some of the other sacrifices, might it not, then?

A. Yes, and that is a partial compensation and that compensation is needed.

Q. Do you oppose the Debtor's suggestion that the maturity stay where it is today at 1989, in other words, not change the maturity?

A. Personally I would prefer the 30-year maturity for the limited amount of fixed interest bearing bonds that would flow to the portfolio of the institutional investors holding the present general mortgage bonds.

Q. Well, does that mean that you would oppose, you said you preferred it.

A. I think it is very desirable, I think they are a better bond, and my own feeling is that that would be very preferable.

3176 Q. If the Commission should agree with the Debtor that the maturity of the bonds, these bonds, should not be accelerated by twenty years, would not that affect

your opinion as to the proper date of maturity for your income bonds, you have them maturing now at 50 years, the same time which the general mortgage bonds mature.

A. Yes, it would, they should.

Q. There would have to be some postponement in that case, would there not?

A. Postponed for a substantially equivalent number of years.

Q. So that if the Commission should accept the Debtor's suggestion in connection with the first mortgage bonds you would think it wise that they also accept the Debtor's suggestion in respect of the extension of the maturity of your proposed new income mortgage bonds?

A. That is true.

Examiner Jameson: The income bonds are in two series, aren't they, maturing at different times?

The Witness: Yes, sir.

Mr. Swaine: Fifty and sixty years in the institutional investors plan, and 65 and 75 years in the modifications proposed by the Debtor.

Director Sweet: Different maturities for the two issues of the income bonds.

3177 Mr. Swaine: We followed their suggestions. You understand the Debtor takes no position as to the propriety of that provision, because it is tied up with the question of the rest of the 50-year bonds, and the general mortgage bonds, and our position is that we haven't enough information today, although we have lived with the property a long while, to know whether that is a fair division or not, so that what we did was simply to check through—we felt convinced that the first mortgage bonds should be extended, and it seemed to us to follow that the income mortgage bonds, as Mr. Walker has testified, should be correspondingly extended, and we adhered to their structure.

Q. Now, the income so far as available must be applied in payment of the income bond interest, must it not, Mr Walker?

A. After—

Q. After the—

A. Improvement and betterment—

Q. After two and a half million of what you have called the mandatory fund.

A. Yes, sir.

Q. Additions and betterments fund. Now if that should be inadequate, and I understand there is a difference of

opinion between us, but if it should prove that the
3178 amount which your plan permits the reorganized company to use for additions and betterments, was less than the amount which the management felt necessary for safe and proper operation of the property, then the management would be faced with one of two things, would it not, under your plan, either to default in the payment of general mortgage bond interest under the mandatory provision, or to default in the making of what the management thought were the necessary additions and betterments.

A. Or providing the necessary funds to obviate each of those defaults through the issue of additional securities and the realization of cash from those securities, either by pledge or sale.

Q. Well, we have just assumed that you haven't earned anything on your income mortgage bonds, you would not be very apt to be able to sell any kind of security under those circumstances, would you?

A. Might pledge, and what you would do therefore.

Q. And what you would do, therefore, would depend upon ability to take down against those betterments?

A. That is true.

Q. Oh, I thought you agreed with me a little while ago that conservative provisions regarding the issuing of securities should apply then at the time of sale or
3179 pledge and not at the time of authentication?

A. I said that the issuing should apply at the issuing, and you have them in the treasury, and in addition to that if what you are now stating, the requirement for additional funds for improvements and betterments is so vital that the company would either have to default on its new first mortgage bonds or else have to endeavor to get away from these improvements and betterments which were forced upon it, you have possibly the foundation for emergency, with a ten million dollar emergency fund provided for that purpose, and you have also a replacement of that fund. But of course assuming that this property never will earn more than enough to take care of its fixed interest and this two and a half million improvement and betterment fund or additions and betterments fund, and then just a small amount on the income bonds, it would be impossible to finance large additions and betterments. Under those circumstances, if it was not going to result in higher income, it would be an unwise investment. If the investment was forced on them by public authorities

we have provided a ten million dollar improvement and additions and betterments fund.

Q. Well, now, in 1935 when we were dealing with this problem we set up a discretionary five million dollar
3180 additions and betterments fund.

A. Yes.

Q. And the modification which we now suggest was along the line of a discretionary five million fund. I understand from your testimony that you think there is advantage to having some part of that mandatory and again we have had no opportunity to discuss that, so I will accept for purposes of this discussion that we will take five million of our discretionary fund and make two and a half million of it mandatory which is the way you have. Now do you see any objection to having an additional discretionary fund to meet the capital expenditures which Mr. Scandrett testified he felt were necessary?

A. If that comes before the payment of interest on the income bonds, that excess discretionary fund, then it would affect, I believe, the value of those bonds and increase the sacrifices of the bondholders, unless the amount of the cumulative interest was increased so that they could recover the additional amount of earnings that have been diverted from the payment of interest on the income bonds, from future earnings.

Q. It isn't possible, is it, to, as a practical matter, effect this reorganization on July 1, 1938?

A. I don't believe that that will be accomplished.

3181 Q. Don't you think, therefore, it would be advisable to make the effective date of the plan January 1, 1939, as the earliest possible date, and fund the interest that will accrue between July 1 and December 31 into new securities rather than issue securities which will absorb any cash which the Debtor or rather the trustee may accumulate during that period.

The Witness: Would you read that question?

(Question read.)

A. Well,—

Q. Is that question too blind?

Q. Well, not exactly blind.

Q. Well, let me—

A. The fixing of a definite date again as to when the plan will become effective, it seems to me does not provide any material change from what has been done in this plan, namely, that if this plan is not consummated on

July 1st, 1938, then the amount of accrued and unpaid interest subsequent to that date and up to the date of actual consummation of the plan, such interest, additional interest as is then accrued and is unpaid there would be treated in accordance with the—

Q. Should be funded?

A. Should be funded on the same basis.

Q. Yes.

3182 A. As the other principle of the claim.

Q. Yes.

A. But I do not want to say that the full amount of interest that runs beyond the first of July, 1938, is to be funded, because there may be no necessity for funding of that full amount of interest, the earnings of the company being such that there would be sufficient cash balance for working capital at the actual consummation of the plan to permit of the payment of some of that interest in the interim to the holders of the present securities.

Mr. Swaine: Well—

Mr. Burgess: You may resume paying some of it.

Q. (By Mr. Swaine.) You testified this morning that you did not believe that the fixed charge interest on your bonds, on your first mortgage bonds, would be earned in the year July 1 to July, and I do not either, I agree with you. I doubt if it will be earned during the calendar year 1938. If, therefore, you issue your securities to July 1, 1938, instead as of January 1, 1939, you will have to pay out your earnings, your cash earnings, for that six months period in interest on your new securities, and by our hypothesis the interest is going to more than absorb the earnings.

A Well, then, as I understand your question now,
3183 what you would like to ask is whether the date of consummation of the plan is subsequent to July 1, 1938, that the date of issuing, the effective date of issuing of the new securities should be preferably January 1, 1939.

Q. Yes.

A. Or some subsequent date.

Q. Or even some time subsequent. Isn't it perfectly clear that it should not be on a date earlier than January 1, and maybe it ought to be a later date?

A. I would not say that. I can see how this road might be brought out of bankruptcy before January 1, 1939. I am not ready to concede for a minute that we would have to stay in bankruptcy for the entire year.

Director Sweet: Would the plan for funding obligations otherwise be apt to help the stockholders situation any?

The Witness: No.

Mr. Swaine: No, of course it could not, Mr. Director. We are interested in a sound capital structure, whether it helps or harms any class of securities, and the point I am trying to bring out that there is very little likelihood indeed, from the information we have, no likelihood that this company will have any cash to pay this interest, and that it ought to have that cash to build up working capital.

3184 The Witness: I might say that in the Commission's plan, on page 34, this statement appears, which possibly answers the same question:

"However, a later date for the new securities may be substituted for July 1, 1938, in which case the basic figures as set forth in the Plan may be adjusted to such later date."

Mr. Swaine: I understand that is a discretionary provision, and we feel just like you do about the additions and betterments fund, it ought to be mandatory.

I think that we both agree. Turning now to the Terre Haute, we both agree that the preferable solution to the Terre Haute is the consolidation of the property of the Terre Haute with the property of the Debtor into the new reorganized company and an issue of first mortgage bonds. Assuming that the Commission should follow the views of the Bureau of Finance, that the Bureau has taken in certain of its tentative reports, and hold that such a consolidation is not permitted, would you object, as an alternative, to the reorganization of the Terre Haute and the acquisition by the reorganized company of the stock, that is, the reorganized debtor of the stock of the reorganized Terre Haute, and the pledge of that stock to the new mortgages instead of the preservation of the lease as the alternative?

3185 A. Well, now, that is a question that I would have to refer, not only to counsel, I would have to sit back and work it through. My idea would be that if it is not practicable to consolidate, the next most practical thing that there is, that is the nearest approach to consolidation and the bringing about of a lien on the Terre Haute should be worked out, that is, a lien of the new mortgages.

Q. That is—

A. Just exactly the machinery of that or the mechanics of it I am not in a position to say.

Q. That is, would you be content with an indirect lien instead of with the direct lien which your plan requires?

A. We would be content with the very best we could get as a substitute for consolidation and which did not perpetuate the Terre Haute lease under all of the circumstances.

Q. So that we really have a question of law which your counsel and the Debtor's counsel ought to work out and see whether we can't provide for an indirect lien instead of continuing this lease which we all agree should not be done if it is possible to avoid it, isn't that right?

A. Only in the event that it is impracticable to
3186 consolidate.

Q. Therefore you would not object to the modification proposed by the Debtor with respect to the terms of the Terre Haute provisions to the extent that the Debtor's counsel should convince your counsel that it would be practicable as a matter of law?

A. If the Debtor's counsel could convince my counsel,

Mr. Swaine: And the Commission, I perhaps should add.

The Witness: And the Commission, rather convince the Commission first and then my counsel, and then after that we could convince the institutional investors that the plan was worked out as a substitute for consolidation, because if it was not permitted or could not be brought about, was the best, the nearest substitute for consolidation, I would say that that would, under those circumstances, be acceptable.

Director Sweet: Maybe this is a good time to do a little convincing. I understand that the Terre Haute is not a debtor company.

Mr. Swaine: It could easily be made one, the Terre Haute has a maturity; if you want to argue that question I am prepared to argue it.

Director Sweet: We do not want to argue it, I just asked the question.

3187 Mr. Swaine: The Terre Haute has a maturity in 1938. It also has an obligation for seven million dollars under the mortgages which have already been testified to. Its elements of value, as has been testified to, are less than the total amount of its bonds. It is in exactly the same situation that the New York Railway Company

in New York was under. In other words, it is insolvent in the bankruptcy sense, the valuation of its property is less than the amount of its matured obligations.

Director Sweet: Now, the question I have in mind is this: If the Terre Haute and the Debtor, bankruptcy trustee or otherwise, agree upon a proposed consolidation, what obstacle is there to affecting a consolidation in connection with reorganization?

Mr. Swaine: I did not think there was any, but you held against me on that in the Spokane International.

Director Sweet: Well, didn't you have a different situation?

Mr. Swaine: Everybody wanted it.

Director Sweet: But did the Coeur d'Alene want it?

Mr. Swaine: Yes.

Director Sweet: How did they evidence it?

Mr. Swaine: The Debtor, which was the owner of 100 per cent of the stock, said so.

3188 Director Sweet: Did the Coeur d'Alene say so?

Mr. Sykes: Yes, we asked for it in our brief.

Mr. Swaine: Yes.

Director Sweet: Not in our record.

Mr. Swaine: Well, you held it could not be done. If that is the basis of your decision we can very quickly correct it. I did not intend to argue the Spokane International case.

Mr. Sykes: We certainly asked for it.

Mr. Swaine: But all of the parties thought they were asking the Commission to consolidate the two properties, and that they were asking effectively, but they were told by the Bureau that it could not be done under the Act.

Director Sweet: Off the record.

(Discussion off the record.)

Director Sweet: Let's proceed with this record.

Q. (By Mr. Swaine.) Now, Mr. Walker, both you and the Debtor are providing, in substance, that if "the various classes of security holders do not assent to the plan in the requisite proportion, the property of the Debtor, or any part thereof, may be sold at public auction at a fair upset price determined by the Court, and the non-assenting creditors of such class shall be entitled to receive their aliquot portion of the proceeds of the sale of such property,

3189 after deducting therefrom all expenses of such sale,"

and so forth, you have such a provision in the plan, on page 46, Article X.

A. That is correct.

Q. Now, the Debtor taking into account decisions of the Bureau of Finance, or tentative reports of the Bureau of Finance, and particularly taking into account the recent reports of the Bureau of Finance in the Chicago Great Western case, which was handed down at about the time we were talking about.

A. Yes, sir.

Q. Modified your provision in accordance with Article 8 of Exhibit—what is the last number; whatever it is, it is on page 15.

Mr. Burgess: Exhibit 189.

Q. (By Mr. Swaine.) I take it that that is another provision as to which we are in agreement on intent, is it not?

A. Yes, sir.

Q. And therefore if the provision which your plan suggests flies foul of the decision of the Bureau of Finance, or the tentative report of the Bureau of Finance in the Chicago Great Western case, whereas the modification proposed by the Debtor meets it, and I might say that was the intent of that modification, then you would agree that we ought to try to reach the same end by something
3190 that was within the Commission's ruling, would you not?

A. I would agree that if that Article X in the Committee's plan requires revision in the opinion of counsel for the Committee, after consulting with other counsel, etc., in order to accomplish its purpose, that it should be redrafted. I am not in a position to say whether the redrafting—

Q. I understand you are not, but you rejected our proposed modification. I am merely raising a question whether it was a studied rejection or whether it is still open to us to sit down together and try to work out some of these legal and business problems.

A. Legal matters, of course, would be discussed between counsel and if possible they should harmonize their views of the law, but I am not in a position to—

Q. I apreciate you are not.

A. —to discuss matters of that kind.

Q. Yesterday there was discussion as to the provision for a voting trust, of which, under your plan, the Committee was to name two and a possible third, that is, your Committee and the holders of the preferred and common

stocks were to name two. Do you not think that the likelihood of securing assent, which you state is one of the objectives of this plan, would be increased by accom-
3191 plishing the same character of control through the provision incorporated in the Debtor's suggested modifications of giving to the preferred stock, the new preferred stock, the right to elect a majority of the members of the board until there had been continuity of income in that investment.

A. That might have a likelihood of securing a favorable vote, greater likelihood of a favorable vote from the holders of the preferred stock. But on the other hand it might not have—

Q. You do not mean the holders of outstanding preferred stock?

A. No, the new preferred stock.

Q. That goes to whom?

A. But on the other hand—

Q. To whom does that go?

Mr. Burgess: Let him answer the question.

The Witness: But on the other hand it might have an unfavorable effect upon a favorable vote of the holders of the bonds who are the junior mortgage bonds on the Milwaukee & Northern, the Milwaukee & Northern, the general mortgage bonds, and of course, the Terre Haute in this plan.

Q. The real ownership of this property after its reorganization, if the earnings support it as a sound capital structure, will lie in the new preferred stock, will it
3192 not, that is where the real ownership of the property as constrasted with the creditor position lies?

A. That is the equitable ownership?

Q. Yes.

A. The equity position?

Q. Yes.

A. Will be—I am not ready to say that.

Q. Well, do you think that the real equity ownership lies in the creditors?

A. The equity ownership after reorganization, as I would say, is with the new preferred stockholders and the new common stockholders.

Q. Well, doesn't the provision suggested by the Debtor therefore accomplish the result of giving control to present creditors who are becoming stockholders, without running foul of perhaps a general public antipathy to voting trusts?

A. Oh, that might be, but on the other hand if the control is with the new preferred stockholders initially and the common stockholders, and the provision for the discretionary improvement and betterment fund up to five million dollars before the payment of interest on income bonds is effected, as suggested in the Debtor's modification, then the imposition of the additional two and a half million dollars and the injection of that into the
3193 wedge ahead of the interest on the income bonds would redound to the benefit of the preferred and common stockholders and to the detriment of the holders of income bonds.

Q. Your plan provides that the reorganization managers shall be not more than three, two to be designated by your committee and the third by the R. F. C.?

A. Yes.

Q. Do you oppose the modification suggested by the managers that the reorganization committee should be made up of one representative of the general mortgage bonds, one of the 50-year 5s, one of the adjustments, one of the Terre Haute taken as a group, and one of the R. F. C., chosen in such manner as the Commission may determine; that is, giving representation to the bondholders by classes of their holdings rather than by placing control in your committee?

A. There would be merit in that provided that you can find representative representation of these various classes of securities. The difficulty, as I see the situation at the present time, is that the institutional investors have to carry the burden.

Q. You could nominate a representative for each of those classes, couldn't you, you hold some of the securities of each of the classes, except of the R. F. C.?

3194 A. That is very true.

Q. So that you could nominate four out of the five, and at an election supervised by the Commission under this provision in the Debtor's plan could get four out of the five of the representatives. Have you canvassed the various classes of security holders, or that could be done?

A. Why surely, we could do that.

Q. Now, to come to the major difference between the Debtor and the institutional plan, the treatment of the stock. You will concede, will you not, that whether or not this plan has any practicality at all depends upon future events that we do not know?

A. That would depend upon what you call "future events".

Q. Well, it depends upon a rate decision for one thing, doesn't it?

A. That is one thing, yes, sir.

Q. In other words, as the Director said, there are a tremendous number of uncertainties. Now, isn't the possibility of inflation and a great decrease in the purchasing power of the dollar one of the uncertainties that ought to be taken into account?

Mr. Burgess: I object, no proper foundation having been laid for that question.

3195 Director Sweet: He may answer, if he can.

Mr. Swaine: Isn't that an uncertainty?

The Witness: Why, there are a number of things.

Q. Do you believe "it can't happen here"?

A. I am one of those who are of the opinion that "it can't happen here" in this country. Inflation, as it is generally understood, in my opinion, will not occur in this country.

Q. If inflation should occur of course it would vastly increase the value of the equity, would it not, in terms of dollars, and permit the paying off of debt in terms of low dollars?

A. If debt could be paid off in low dollars then it would be paid off in low dollars.

Q. And you have protected yourself against that eventuality by inserting a conversion provision in the general mortgage bonds as a hedge against inflation, have you not?

A. I have not hedged against inflation, no.

Q. You would not deny that you have heard the term used in discussions with your committee, would you?

A. I do not know what you heard.

Mr. Burgess: During that two hours?

Mr. Swaine: Yes.

The Witness: I do not know what you heard during the discussion with that committee, but you never

3196 heard me say that.

Mr. Swaine: I agree to that statement.

Q. (By Mr. Swaine.) Now, don't you think something is to be said for the proposition that these uncertainties should not all be resolved in favor of the senior creditors and against the holders of the equity?

A. They are not so resolved, just on the basis that the

possibilities as they are seen in this picture are merely founded on nothing but future difficulties that may arise.

Q. Well, Mr. Walker, if this property should ever resolve its uncertainties by coming back at some future date to a level of earnings in terms of dollars equal to those of 1928 and 1929, or the dollar profit, under your plan, it would redound to the benefit of the creditors, would it not?

A. It would redound, but in the interim during that time when this imagined inflation is going to be upon us, the present creditors by reason of the lack of ability to accumulate for income bond interest and preferred stock dividends, would have in the property a great deal more money than they now have in it.

Q. Not if that reversion should come with the promptness that some of the optimism which you seem to think is not impossible.

3197 A. Well, you may—

Q. Have you considered the possibility of giving to the stockholders, if they ask for it, means by which they can have in effect an equity of redemption and buy into the property over a period of years?

A. As I have stated in other cases, if the stock, equity of the stock, is of no value, and as I have stated here, the creditors cannot give to the stockholders a warrant unless it has some value.

Q. Well, that is—

A. And if it has value then the creditors who believe that the equity has no value have departed from their own belief.

Q. Well, the stock—

Mr. Burgess: There is some legal question involved there, Mr. Director. It seems to me that, I would be very glad to argue those on brief at the oral argument with Mr. Swaine:

Mr. Swaine: I wondered why the stockholders were excluded from any resolution of the uncertainties in their favor by being excluded from any right to purchase.

Mr. Burgess: I am going to take the position in this case on brief that the stockholders had,—that their
3198 equities had no value at the time of the last reorganization.

Mr. Swaine: All right.

Director Sweet: Well—

Mr. Burgess: There haven't been any developments since—

Director Sweet: Well, as I understand Mr. Walker, he has not been willing to give stockholders any consideration because he thinks the interest has no value, and that is the whole answer.

The Witness: That is the answer.

Mr. Swaine: Well, the adjustment mortgage bonds have no value on the basis of present earnings, have they?

The Witness: The adjustment mortgage bonds have a value on the basis of prospective earnings.

Q. (By Mr. Swaine.) That depends upon resolving all the uncertainties in determining what is prospective.

A. And in doing that I believe we have been fairly pessimistic.

Mr. Swaine: That concludes my cross-examination of this witness.

Director Sweet: Is there any further cross-examination of Mr. Walker? (No response.) I imagine he will not object to being excused after three days on the stand, if nobody wants to examine further.

Mr. Burgess: The next witness is Mr. Scruggs.

3199 Director Sweet: Mr. Jameson wishes to ask Mr. Walker a question.

Examiner Jameson: Mr. Walker, on page 9 of the plan, statement of liabilities.

The Witness: Yes, sir.

Examiner Jameson: I was trying to check some of those figures and I did check them all except a few accounts. The Debtor's exhibits that show the obligations as of June 30, 1938, have these figures all been obtained from the Debtor directly, or from his exhibits, or have you introduced any new figures of your own in this statement?

The Witness: We have not introduced any new figures.

Examiner Jameson: Computations, I mean.

The Witness: There have been some computations as to accrued interest that have been made and which I believe are correct. We checked them through. There is one item in there, general creditors, of $445,000, which is an estimate furnished by the Debtor.

Examiner Jameson: I was just wondering if you had been over that with the Debtor's representatives to be sure that they agreed with all of those figures.

The Witness: The figures were checked.

Examiner Jameson: By them?

The Witness: In the Debtor's accounting office, by
3200 a representative, one of my representatives who went down after I had made the calculation, and I was advised that they were correct.

Examiner Jameson: I see. That is all.

Mr. Burgess: Are there any other questions of Mr. Walker? (No response.)

(Witness excused.)

Director Sweet: Call the next witness.

Mr. Burgess: Mr. Scruggs, please.

E. D. SCRUGGS was sworn and testified as follows:

Direct Examination.

Q. (By Mr. Burgess.) Mr. Scruggs, please give your name and residence to the reporter.

A. E. D. Scruggs; Hartsdale, a suburb of New York City.

Q. What is your occupation, Mr. Scruggs?

A. I am employed by the Savings Banks Trust Company, am and have been for a number of years an analyst of railroad securities.

Q. And what is the Savings Bank Trust Company?

A. The Savings Banks Trust Company is incorporated under the laws of New York State, and is owned by all of the mutual savings banks in New York State. It functions in connection with investments, revenues on in-
3201 vestments, analyses of various investments in which the mutual savings banks invest.

Q. The Savings Banks Trust Company is one of the members of a group of institutional investors?

A. It is.

Q. In this proceeding, is it not?

A. It is.

Q. Have you done any work in connection with the investigation of the facts concerning the Debtor that led to the preparation of this plan of reorganization that has been presented here?

A. Yes, I was a member of a sub-committee which examined the various records of the company, and I particularly confined my attention to the level of earnings of past years.

Q. Did the sub-committee of which you were a member

prepare a report that has been presented here as Exhibit 185?

A. Yes, it did.

Q. Are the matters and things contained in that report true and correct to the best of your knowledge and belief?

A. They are.

(EXHIBIT NO. 185, witness Scruggs, was received in evidence.)

Q. (By Mr. Burgess.) What have you to say with regard to that report that will in your opinion be
3202 required to make it self-explanatory?

A. Well, I think most all of this exhibit is self-explanatory. It consists of twenty-four pages.

There are a few comments that I would like to make in connection with the major adjustments that we have made. They were all taken from a report of the Bureau of Accounts, submitted June 13th, 1936. The report contains certain adjustments, however, which we did not use. These are, briefly, the social security taxes and the compensation taxes. In my opinion it is not proper to project back into those depression years additional burdens which were not actually incurred. These additional taxes affected all railroads and considering the low level of gross revenues and net earnings of all Class 1 railroads in the aggregate in those depression years, it must be assumed that these additional burdens would have been offset by rate increases or otherwise.

On the other hand the policy of the Milwaukee with respect to its depreciation affected the earnings of the Milwaukee only. Consequently, these depreciation charges were examined to see what relation they had to the reported earnings in the past and what relation they will have in a future period of low earnings.

I believe the rest of the description of the equipment depreciation is self-explanatory.

3203 In connection with the retirement charges I emphasize that these adjustments likewise were made by the Bureau of Accounts.

I think that covers the principal points that I want to mention.

Q. The report then in Exhibit 185, as I understand it, represents the results of the study of the committee of which you were a member?

A. That is correct.

Q. And you worked in Chicago and in Milwaukee on that report, didn't you, Mr. Scruggs?

A. Yes.

Q. One of our friends yesterday in questions directed attention to a so-called shift in the holdings in respect to Milwaukee & Northern bonds as shown in the plan and as shown in one of our exhibits; that is, the holdings of this group of institutional investors. Are you familiar with that shift in holdings?

A. Yes.

Q. What was the occasion for that, was it due to a sale of these bonds, or otherwise?

A. In my opinion, it was not due to any sale, any purchase of bonds, there might have been some sales. The inference, as I gathered yesterday, was that there had been a shift from the Milwaukee & Northern first mortgage bonds into Milwaukee & Northern consoli-
3204 dated bonds. Now the title as generally quoted of these two bonds is very similar. One is Milwaukee Northern first 4½s of 1939 and the other is the Milwaukee Northern first consolidated 4½s of 1939, and in the original list submitted by the Savings Banks Trust Company to the Chairman of the group they were all shown as first mortgage bonds, whereas a part of them were first consolidated mortgage bonds.

Now Exhibit 176 contains a revised list and which accounts for something over $200,000 of the increase in the Milwaukee Northern consolidated bonds, which is merely an error in the statement of issues in the first instance.

As far as savings banks are concerned they cannot buy the bonds of a road in bankruptcy, so I am sure none were purchased there.

Q. The figures so far as the Savings Banks Trust Company is concerned were furnished by you to the Chairman of the Committee on which Exhibit No. 176 was based, were they?

A. Yes, these were furnished by our Committee in January, whereas the figures used in the plan were furnished in 1935, shortly after the company went into bankruptcy.

Q. And as I understand it, this difference in the figures furnished in connection with the statement that was
3205 made at the time of organization of the committee did not deal with this particular differentiation.

A. No, they did not.

Mr. Burgess: That is all from this witness.

Director Sweet: Any cross-examination of Mr. Scruggs? (No response.) You are excused, Mr. Scruggs.

(Witness excused.)

Mr. Burgess: I asked the Debtor to prepare a statement showing a breakdown, or rather an explanation of certain figures that were contained in Exhibit No. 76, and I have been furnished with a statement, by Mr. Oliphant, that contains the material that I requested; that is correct, Mr. Oliphant?

Mr. Oliphant: That is correct, yes, sir.

Mr. Burgess: May I ask that this statement, consisting of two sheets, be received in evidence as Exhibit No. 190?

Director Sweet: Mr. Swaine, did you intend to offer Exhibit 189?

Mr. Swaine: Yes.

Director Sweet: Have you provided copies for everybody or made specific offer?

Mr. Swaine: They have been sent to every party to the record.

Director Sweet: Furnished to the reporter?

Mr. Swaine: What?

3206 Director Sweet: Was a copy furnished to the reporter?

Mr. Swaine: Yes.

Director Sweet: We didn't get any here.

Mr. Swaine: I filed fifteen with you.

(EXHIBIT NO. 189, by counsel, was received in evidence.)

(EXHIBIT NO. 190, by counsel, was received in evidence.)

Mr. Swaine: Would it be possible for me to call Mr. Howland Davis?

Mr. Burgess: Go ahead and call him.

HOWLAND DAVIS, testified further as follows:

Direct Examination.

Q. (By Mr. Swaine.) You have been sworn already, Mr. Davis, have you, in this proceeding?

A. At a previous hearing.

Mr. Swaine: That is right.

Director Sweet: All right.

Q. (By Mr. Swaine.) You are a member of the subcommittee of the board of directors of the Debtor?

A. Yes.

Q. To consider reorganization plans?

A. Yes.

Q. And you participated in the preparation of the
3207 modifications suggested by the Debtor of the institutional investors plan which has been introduced as Exhibit No. 189?

A. I did.

Q. In the introductory statement to that plan, the statement is made that "It is today even more clear than it was then (referring to June and September of 1937) that no plan should be adopted until the basic factors upon which it must be predicated can be more certainly determined than is now possible." Is that your opinion as a Director, in the light of all the facts that you know about this property?

A. It is.

Q. And the introductory statement also says this, "Particularly it is the opinion of the Debtor's board that it is not possible, in the light of present conditions, to feel any assurance that a capital structure involving the fixed and contingent interest charges contemplated by the institutional investors' plan will prove to be sound."

Is that your opinion, in the light of all the facts you have been able to know about this property?

A. It is.

Q. The introductory statement also says that "The time intervening between the submission of the institutional investors' plan to the Debtor (which the record
3208 shows was January 10, 1938) and the date (February 1, 1938) set by the Interstate Commerce Commission for the hearing thereon has been too short to enable the board of directors of the Debtors to come to any final conclusion as to the fairness of the relative treatment provided by the institutional investors' plan for the Debtor's general mortgage bonds and 50-year 5 per cent bonds of 1975, and for the Milwaukee & Northern first mortgage bonds and consolidated bonds." This problem is rendered more difficult of solution the more radically the proposed fixed and contingent charges are reduced."

Have you been able to have any studies made which would enable you to determine the value of the changes

of lien that were first brought to your attention on January 10, 1938?

A. No. I have heard that matter discussed, but there has been no opportunity for study.

Q. You directly represent on the board very large blocks of stock, do you not?

A. I was nominated, suggested as a director by the Dutch administration office, which holds large blocks of both common and preferred stock.

Q. Will you please state to the Director, in your own way, why you think the modifications of the institutional investors' plan suggested by the Debtor with respect to the treatment of preferred and common stock should
3209 be made?

A. I am probably going over ground that has been covered previously by me and perhaps by other people and perhaps better than I can cover it myself, but it does seem to me that from the stockholders' point of view this is a time of great uncertainties, uncertainties with regard to business, uncertainties with regard to volume of traffic, uncertainties with regard to rates, and it does seem to me that these uncertainties make this a time when if is very difficult, if not impossible, to prepare a plan which you may be sure is both sound and fair. And I agree with what counsel for the Debtor has said, that it seems to me somewhat unfair to shareholders to resolve all these uncertainties against the shareholders at the present time.

The shareholders must admit that their equities have no value if judged only on present day earnings. The shareholders must also admit that they have an obligation to their creditors, which they do not want in any way to deny, but bearing fully in mind their obligation to their creditors and also bearing in mind the amount of money that has been spent on this property, the amount of assets that are available to produce a valuable public service, it does seem to me that the shareholders should not be entirely wiped out but should be given some
3210 chance, even if by rebuying their admission into the situation, given some chance to participate in the future if things go well.

Director Sweet: Do you think that, in view of the fact, I understand Mr. Walker to say, that the stockholders have received nothing, at least common stockholders have received nothing from this railroad in more than twenty

years, that there is some possibility that they have a value today?

The Witness: I do not know that my opinion as to whether they have a value would be very useful, but I could say that I think that if they have a value that they should be given some chance to maintain it. I am not so sure as to whether I can demonstrate a value, but I think that if there is a value there they should be given some chance to retain it in the future.

Director Sweet: Well, if you cannot demonstrate a value, what chance should be given or could properly be given in view of the treatment that is proposed to be given for instance to general creditors?

The Witness: Well, when I said "value" perhaps I was thinking of present current market value. It seems to me the value of their interest in the property here is the value in assets, assets that perhaps have a potential future earning power.

Director Sweet: Do you think they have some potential future earning power although over the past
3211 twenty years they have had no earning power?

The Witness: Under favorable circumstances. I understood, perhaps I didn't hear it correctly, I understood Mr. Walker to say that during that period he believed it had earned some money but had not paid any dividends to the stock.

Mr. Swaine: I think, Mr. Director, that the record shows that they did have earning power.

Director Sweet: They didn't receive any dividends for over twenty years.

Mr. Swaine: It was plowed back in. It is true that no dividends were paid, but it is not correct that the earnings failed to cover interest during all of that period without any margin.

Director Sweet: There is no doubt that no dividends were paid and the directors declared no dividends for more than twenty years.

The Witness: That is correct.

Mr. Swaine: That is correct.

Mr. Burgess: How long have you been a director of this railroad?

The Witness: My recollection is that it was October, 1929; I can't remember the election and the confirmation by the Commission, but I think October, 1929, is within a month of it.

Q. And you have been a director continuously since?

3212 A. Yes, sir.

Mr. Burgess: That is all.

Director Sweet: Any other questions? (No response.) You are excused.

(Witness excused.)

3213 Mr. Burgess: I have a question or two of Mr. Douglass and then I will close my case.

Mr. Douglass.

GEORGE S. DOUGLAS was sworn and testified as follows:

Direct Examination.

Q. (By Mr. Burgess.) Please state your name, residence, and occupation, Mr. Douglass?

A. George S. Douglass; Washington, D. C.; I am Coordinating Engineer for the Bureau of Valuation of the Interstate Commerce Commission.

Q. Pursuant to orders of the Bureau of Valuation there was submitted for the record in this proceeding, certain reports of the Bureau of Valuation which were filed on August 5th, 1936, and thereafter modified by order dated November 14th, 1936.

Are you familiar with those reports, Mr. Douglass?

A. I am.

Q. Were they prepared either by you or under your direction?

A. The portions pertaining to reproduction cost were prepared under my direction; the remainder of the Exhibit I am familiar with.

Q. Now, in the report there are estimates of reproduction cost new, less depreciation, and other so-called

3214 elements of value, and I ask you whether you made any findings of the value of the property of the Chicago, St. Paul and Pacific Railroad Company?

A. There is no finding of value in the Exhibit, only the elements of value, or the so-called elements of value.

Q. And did you make any attempt in that Exhibit in any way to find or ascertain the value of the Chicago, Milwaukee, St. Paul and Pacific Railway Company?

A. No, sir.

Q. Either based on earnings or any other basis?
A. No, sir.
Mr. Burgess: That is all.
Mr. Swaine: Any cross-examination of Mr. Douglass?
(No response.)
You are excused.
(Witness excused.)
Mr. Burgess: That concludes the case for the group of institutional investors.
Mr. Swaine: I would like to call Mr. Dick, if I may.
Mr. Dick.
Mr. Clay: We have one witness, Mr. Swaine.
Mr. Swaine: Well, is your man trying to get away?
3215 Mr. Clay: No.
Mr. Swaine: Just as you say.
Mr. Clay: We are quite willing to go ahead, if that is agreeable to you.
Mr. Swaine: Well, Mr. Dick would like to get back to New York.

FAIRMAN R. DICK testified further as follows:

Direct Examination.

Q. (By Mr. Swaine.) Mr. Dick, you were a member of the Sub-Committee that participated in the preparation of the Modification of the Institutional Investors' Plan, were you not?
A. Yes.
Q. You agree with the statements of opinion that was stated in the introductory statement?
A. I do.
Q. Will you please state to the Commission, in your own way, two things:
First, whether you believe it is possible to, at this time, have a reorganization of the St. Paul, in the light of the known facts, and, second, what you think is the effect of omitting from the new securities the provision with respect
to limitations upon increase of indebtedness, a provi-
3216 sion designed to encourage equity financing, what the effect of it is upon the credit of the reorganized company, particularly the salability of its securities.
A. As you say, Mr. Swaine, I adhere to the statements

in the modifications, that no reorganization should be permitted at the present time.

At the prior hearings I presented an analysis of my reasons in support of this view. I do not intend here to go over this ground again, I will merely try at this time to emphasize, in my own words, some of the salient points of the problem.

The problem as I see it, is the problem of devising a plan to restore the Milwaukee Road to solvency, with its credit restored so that it can continue to modernize its plant in order to supply the public with continually better service at reasonable rates.

It is the need for continuous modernization that makes credit necessary. This is well recognized by the Commission and was clearly stated in what is known as the O'Fallon decision in 1927, and again repeated in the decision in Ex Parte 115. In the words of the Commission, a "railroad system, so long as it is privately owned, obviously cannot be provided and maintained without a continuous inflow of capital."

3217 In the decade prior to the depression, the Milwaukee Road earned 3 per cent on its investment, a figure closely comparable to other roads in its territory and, during the depression, the earnings have averaged approximately 1 per cent on its investment. Any plan which attempts to insure a continuous flow of capital under these conditions must, on the face of it, break down because if it is assumed that earnings will be so low as to repel capital it cannot at the same time be assumed that capital can be continuously attracted merely through adjustments in the capital structure.

Stated in slightly different language, plans of the type now proposed for the Milwaukee Road are, so to speak, attempts to compel the restoration of credit notwithstanding an assumption that earnings are such as to make it impossible to restore credit.

I, for one, do not wish to acquiesce in any policy which not only attempts the impossible, but in addition may tend for a time to deceive the public into believing that the impossible can be accomplished.

In the decision of the Commission in Ex Parte 115, the underlying principles involved in this problem were, in my opinion, clearly and correctly analyzed. It was stated,

3218 "In the long run no private corporations can continue to attract private capital unless it is able to market stock as well as bonds."

If it is assumed, therefore, that the Milwaukee Road must continue to attract private capital, in the long run it must attract new money through sales of stock and other junior securities, and, furthermore, issuance of these securities must be at prices where, in the long run, no dilution of security values takes place because the dilution of security values and the piling on of debt results ultimately in financial breakdowns. This fundamental principle of sound financial policy is mentioned in order to call attention to the fact that the forecast of earnings on which the creditors' plan is based will not permit in the future the methods of financing stated by the Commission to be sound.

Even if it were desirable to call upon creditors and stockholders to make the most radical sacrifices of their present position in order to conform to a level of earnings which foreshadow future financial difficulties, the spread between revenues and expenses is now so low that another financial breakdown might occur almost immediately.

In the present plan, the fixed charges of the Milwaukee Road are scaled to approximately 6.5 per cent of
3219 the 1937 gross revenues.

The net railway operating income in 1937 equalled 8.2 per cent of the gross revenues. In other words, the margin of safety for the new proposed first mortgage bonds is equal to 1.7 per cent of the 1937 gross, excluding nonoperating income which amounts to roughly 1.1 per cent of 1937 gross.

Obviously, this protection is totally inadequate because even what might be called minor fluctuations in both expenses and revenues far exceed this margin. As a result of this low margin, and the uncertainty as to the future, the price of securities of the Milwaukee and other roads with inadequate earning margins reflect great distrust on the part of investors.

The old general mortgage bonds of the Milwaukee are now selling at about 30. It is my opinion that the new proposed first mortgage, if outstanding today, would certainly not sell above 50. Even temporarily, therefore, a reorganization of the Milwaukee would not reestablish sound credit conditions, or in fact supply the road with any credit whatsoever, even in respect to its new first mortgage, and, of course, as I have pointed out, and as the Commission emphasized in principle in their last decision, sound credit

conditions require that the junior securities of the
3220 Milwaukee must in the long run be marketed at satisfactory prices.

It is for these fundamental reasons that I state again that I do not think any plan for the Milwaukee Road should be promulgated today, nor indeed should any plan be promulgated in the future until there can be a reasonable *assumption that there is at least a* prospect of junior financing under such terms and conditions as to make possible the avoidance of future bankruptcies.

The modifications suggested by the Debtor, in my opinion, are sound in principle. In other words, a method of limiting the increase in the debt ratio is set up and likewise provisions compelling or inducing junior financing.

It should be pointed out, however, that the soundest and most conservative financial standards are nothing but scraps of paper unless earnings are at a level which permits these standards to be made effective.

It is for this reason that my approval of these modifications does not carry with it an approval of the plan, even if modified, for the fundamental reason that the plan has its very base a level of earnings which will either compel the future management to attract money for improve-
3221 ments through unsound financial practices or else will prohibit the management from continuing to modernize the plant.

Q. Your private business is that of an investment banker dealing primarily in railroad securities, is it not?

A. Yes, Mr. Swaine.

Q. In your opinion is an adequate financing medium provided under present conditions under the Debtor's plan, even as modified by the Institutional Investors' Plan?

A. Well, as I have said in this statement, and as Mr. Walker said, under present conditions the new first mortgage could not be sold if it were outstanding today.

Mr. Swaine: That is all.

Director Sweet: Any cross-examination?

(No response.)

The witness may be excused.

Mr. Clay: I have a question, or so.

Director Sweet: All right.

Cross-Examination.

Q. (By Mr. Clay.) You have testified on matters affecting the first and refunding mortgage property; is it your opinion that the first and refunding mortgage
3222 bonds outstanding in the amount of some $8,900,000 are fully and adequately secured?

A. Mr. Clay, that is a question of definition. I myself feel that those bonds are unquestionably, under any theory of economics that I know of fully secured.

In other words, I think that the Western Lines are a very valuable public facility on which $250,000,000 was spent, I believe. I remember in the St. Paul investigation, in 1926, it was shown that something like 66 per cent of their traffic either originated or terminated at non-competitive points.

In other words, if it was abandoned, 66 per cent of the shippers or receivers would have no railroad. In other words, it is unthinkable to me that the property is worthless and can be abandoned.

Director Sweet: Then your answer to Mr. Clay's question is yes?

The Witness: Absolutely yes.

Mr. Burgess: Well, I thought it was yes and no.

The Witness: No, it is yes. If you wish me to give any further views I will be glad to, Mr. Clay, but I didn't think you wanted me to take the time.

Q. (By Mr. Clay.) Let me ask you one more question just so that I am perfectly clear as to what you mean.
3223 If the holder of these bonds could obtain possession of the mortgage property, has there been any time since the bonds have been outstanding when the holder of the bonds would not be paid in full, on a scrap basis, or take it any way you want to.

A. Well, I made some studies of it on a scrap basis. The scrap value I think was 50 per cent more than this eight million dollars that you mention.

Mr. Burgess: $8,900,000.

The Witness: But if the Western Lines are a valuable public facility I cannot conceive how they can be worthless, it is inconceivable.

Q. (By Mr. Clay.) You are talking about just that part of the Milwaukee property which constitutes the West-

ern Lines and you have no reference to the other parts of the system?

A. No, no, just the Western Lines, and a few branches of Eastern mileage which are under the First and Refunding and extension mileage.

Mr. Clay: That is all I have.

Director Sweet: Are there any other questions of Mr. Dick?

Q. (By Mr. Pantaleoni.) Are you fully familiar with the formula of allocation as between Western and Eastern Lines?

3224 A. No, not at all.

Q. Through conference or otherwise?

A. Well, I discussed the results with Mr. Sparrow. I do not carry in my mind now the detailed formulae by which he obtained those results.

Mr. Pantaleoni: That is all.

Mr. Burgess: How long have you been a Director of this railroad, Mr. Dick?

The Witness: It was before Mr. Davis, just how much before I do not know, but I think it was early in 1929.

Mr. Burgess: 1929?

The Witness: Yes, sir.

Mr. Burgess: Thank you.

(Witness excused.)

Mr. Clay: May I call Mr. Barriger?

Director Sweet: You may.

JOHN W. BARRIGER, III, was sworn and testified as follows:

Direct Examination.

Mr. Clay: To complete the record, insofar as it relates to our claims, I would like to offer ten reports and orders of the Interstate Commerce Commission relative to the loans made by the Reconstruction Finance Corpora-

3225 tion, being the report in 184 I. C. C. 439, 184 I. C. C. 714, 202 ICC 597, 207 ICC 163, 212 ICC 459, 212 ICC 523, 212 ICC 525, the same volume, 687, 217 ICC 223, and the same volume 298.

(EXHIBIT NO. 191, the document above referred to, was received in evidence and was marked as "Exhibit No. 191, by counsel.")

Mr. Clay: Also an order of March 29th, 1935 relative to the four million loan, and orders relative to the loan made by the Public Works Administration. Copies of these have been distributed, and to save time I will not read the citations unless it is desired.

Mr. Swaine: Those reports and orders will not be necessary for purposes of the Commission's record.

Mr. Clay: The purpose of this, Mr. Commissioner, are decisions which hold that reports are not a part of the record unless specifically made a part of a particular record before the Commission. I am not concerned about what the Commission will do on this record, but I am concerned by the fact that this is a record that is going to be certified to the Court upon which the Court will act. That is the sole and only purpose.

3226 Director Sweet: We will receive it for purposes of the record that goes to the Court. For the purposes of the Commission's record, I doubt if they will be necessary.

Do you want that marked as three Exhibits?

Mr. Clay: I think it would be simpler if they were marked from the last Exhibit Number, which was, I think, Number 190, from 191 on through 208.

Director Sweet: I think first you will have to go through the list and identify the document you wish to have marked a new number.

Mr. Clay: Well, may I mark them as two exhibits, the ten reports and orders relating to the Reconstruction Finance Corporation Loans being Exhibit No. 191, and the eight relative to the P. W. A. Loans as Exhibit No. 192.

Director Sweet: They may be so marked.

(The document above referred to was received in evidence, and was marked as "EXHIBIT NO. 192, by Counsel.")

Mr. Clay: Included in the papers just handed up, is a document, being the last document which I am not sure is to be found in the Commission's Orders, a copy of the financing contract with the Public Works Administration for Equipment Trust M. I should like to offer that 3227 separately as an Exhibit, as Exhibit No. 193.

Director Sweet: It may be so marked.

(The document above referred to was received in evidence, and was marked as "EXHIBIT NO. 193, by Counsel.)

Mr. Clay: Now, I have a series of five letters, the first being a letter from Mr. Fairman Dick to Mr. Frank C. Wright of the Public Works Administration, dated January 19, 1934, which I would like to offer as Exhibit No. 194.

Director Sweet: It may be so marked.

(The document above referred to was received in evidence, and was marked as "EXHIBIT NO. 194, by counsel.")

Mr. Clay: A second letter of Mr. F. H. Ecker, to the same Frank C. Wright, dated January 22, 1934, which I would like to have marked as Exhibit No. 195.

Director Sweet: It may be so marked.

(The document above referred to was received in evidence, and was marked as "EXHIBIT NO. 195, by counsel.")

Mr. Clay: The next being a letter from Fairman R. Dick to Joseph L. White, of the Public Works Administration, dated January 26th, 1934, which I offer as Ex-
3228 hibit No. 196.

(The document above referred to was received in evidence, and was marked as "EXHIBIT NO. 196, by counsel.")

Mr. Clay: Next a letter of January 31, 1934 from M. N. Buckner to the same Frank Wright, which I offer as Exhibit No. 197.

(The document above referred to was received in evidence, and was marked as "EXHIBIT NO. 197, by counsel.")

Mr. Clay: And lastly, a letter of Fairman Dick to Director Sweet, dated November 13, 1934, which is offered as Exhibit No. 198.

(The document above referred to was received in evidence, and was marked as "EXHIBIT NO. 198, by Counsel.")

Q. (By Mr. Clay.) Mr. Barriger, will you state your name and briefly your previous railroad experience?

A. My name is John W. Barriger, III. I am now Chief Examiner of the Railroad Division of the Reconstruction Finance Corporation, having been in that position since June 1st, 1933.

I am a graduate of Massachusetts Institute of Technology, Class of 1921; 38 years old; civil engineer by train-

ing; in the service of the Pennsylvania Railroad 1917
3229 to 1927 variously in the Maintenance of Way and the Transportation Departments, and from 1927 to 1929 was in the Statistical Department of Kuhn, Loeb and Company, and 1929 to coming down here was with the investment banking firm of Calvin, Bullock.

My duties in those two previous positions, as well as with the R. F. C. have been analysis of railway financial problems and studies of railway systems from operating, traffic, financial, and corporate standpoints.

In connection with such work I have endeavored to keep in close touch with railway conditions by spending a large part of my time on the line and meeting railway officers and studying operating and other conditions at first hand.

In connection with such work it has twice been my privilege since I have been with the Reconstruction Finance Corporation to go over the Milwaukee, in company with officers of the Railroad, and study the property.

Q. In what year?

A. 1935 and 1936.

A comprehensive report on the Milwaukee was prepared by the Railroad Division of the Reconstruction Finance Corporation, under my direction.

3230 Director Sweet: Off the record.

(Thereupon an informal discussion was had off the record, after which the proceedings were resumed as follows:)

Q. (By Mr. Clay.) Did those trips include inspections of the Western Lines?

A. Yes.

Q. Now, were the documents which have been offered in evidence prepared from records in your Office, and are they true copies?

A. Yes, sir.

Q. Will you comment, briefly, on the value of the Western Lines and of the securities under the First and Refunding Mortgage.

A. In reference to the assets on which the First and Refunding Mortgage is a first lien, I think there can be no doubt that their value on a minimum basis succeeds substantially the amount of this debt.

Details of the mileage mortgaged and securities pledged are in the record and need not be repeated here.

The principle security pledged is the 15,198 share of Indiana Harbor Belt capital stock, representing all but two shares of Milwaukee's 20 per cent interest in this
3231 most important of the several Belt Lines around Chicago. The I. H. B. is recognized as outstanding in that area in its traffic and operating advantages.

It has consistent earning power to cover its dividend of $20.00 a share, which is the current rate, is conservatively capitalized, and is in a sound cash position.

While its earnings in 1937 were slightly under $20.00 a share, the consistent earning power of that railroad has been in excess of its dividend requirements.

The New York Central System holds 60 per cent interest in the Indiana Harbor Belt, and the other 20 per cent is held by the Chicago and North Western, which stock, incidentally, is directly pledged with the Reconstruction Finance Corporation. In my opinion it could be sold without—

Q. Mr. Barriger—

A. Yes.

Q. Pledged with the R. F. C., but not for this loan?

A. No, I said the North Western's interest was directly pledged with the R. F. C., so we are concerned with this 40 per cent minority interest.

I feel it could be said without fear of contradiction that if this 20 per cent interest in Milwaukee were avail-
3232 able for sale, any one of the principal trunk lines would consider an opportunity to buy this stock at $200 per share for the $3,000,000, as an unheard of opportunity, in fact, it could be sold for much in excess, probably several times this figure, if available for sale.

I do not think it beyond the range of possibility that it could be sold for a sum equivalent to the entire outstanding amount of these first and refunding mortgage bonds, if sold under favorable conditions. It has a great value to any of the Trunk Lines, particularly to the New York Central System, and would make it equally advantageous for the New York Central to acquire this minority interest to strengthen its control and prevent sharing management and the benefits of this property with other eastern lines in this great traffic gathering and distributing belt line at Chicago.

Q. Have you a series of five exhibits on the Indiana Harbor Belt Railroad?

A. Yes, they are already in.

Q. You have handed up to the desk, four Exhibits, consisting of

(1) General Balance sheet, which I would like to offer as Exhibit No. 199.

3233 (The document above referred to was received in evidence, and was marked as "EXHIBIT NO. 199, Witness Barriger.")

Mr. Clay: Next an Income Account, to be marked Exhibit No. 200.

(The document above referred to was received in evidence, and was marked as "EXHIBIT NO. 200, Witness Barriger.")

Mr. Clay: Next a statement of the dividend record, which is offered as Exhibit No. 201.

(The document above referred to was received in evidence, and was marked as "EXHIBIT NO. 201, Witness Barriger.")

Mr. Clay: Next a list of the Connecting Railroads, which is offered as Exhibit No. 202.

(The document above referred to was received in evidence, and was marked as "EXHIBIT NO. 202, Witness Barriger.")

Mr. Clay: I likewise offer as Exhibit No. 203, a map showing the Indiana Harbor Belt Railroad and its connections.

(The document above referred to was received in evidence, and was marked as "EXHIBIT NO. 203, Witness Barriger.")

Q. (By Mr. Clay.) Mr. Barriger, were those Ex-
3234 hibits prepared by you or under your supervision?

A. Yes, under my supervision.

I would like to add, if I may, for the record, information just received over the telephone, and available since these Exhibits were prepared, respecting the 1937 Income Account.

Gross Revenues last year were $10,395,000; Operating Expenses $6,779,000; net railway operating income $1,710,000; Available for Charges $1,750,000; and net income after all deductions $1,263,000, representing $16.62 per share.

And I would like to make one correction in this tabulation of 1936 dividends shown therein as $20.00 a share. It was actually $21.00 a share, $20.00 a share was the 1937 distribution.

The $20.00 per share current dividend being paid by the Indiana Harbor Belt represents an income of over $300,000 a year on the pledged stock, or approximately 3 per cent, or half the coupon rate on the First and Refunding Mortgage Bonds.

In addition, there are pledged under this mortgage many other assets, including $1,515,000 Chicago, Terre Haute and South Eastern Refunding 5's and $38,000 of Milwaukee and Northern First 4½'s. Publicly held bonds of these
3235 issues have not passed into default in this or the last Milwaukee Receivership, and these bonds are accorded par in new First Mortgage Bonds in the Institutional Creditors' Reorganization Plan.

Q. Is not that observation also true with respect to the $20,000 of Milwaukee Northern Consolidated Mortgage Bonds that are included in this collateral?

A. The Consolidated Bonds have received their interest, but I believe they are—

Q. To date?

A. They are not accorded par in New First in the Plan, I believe.

Q. Well, the Plan will speak for itself.

A. Yes, sir.

Q. Now, have you any further comments on the collateral?

A. On the collateral, I think I have covered the essential points on the collateral.

But to discuss the property mortgaged: Evidence has been placed in the record showing that a deficit results from the operation of the Milwaukee Lines west of the Missouri River. This fact probably has never been questioned, as whenever the financial problems of the Milwaukee are discussed, the lack of operating profit from the Western Lines is recognized.

3236 However, there are presumably some system advantages from continuing operation on these 3,000 miles of Western Lines or effort would be made to effect their sale or abandonment.

To look at the most pessimistic possibilities, I think there could be no question that these lines could be sold the Northern Pacific for $3,000 a mile, or the property could be salvaged for an equal amount. If so, approximately 3,500 miles of line would return $10,500,000.

Computed on the most conservative basis, there are not

less than 600,000 tons of rail and fastenings in those lines, which, on the most conservative basis of value for relay purposes, because that is not scrap rail, it is good relay rail, it would be worth at least $15.00 a ton.

Q. In other words, $9,000,000?

A. Yes, and if you went on to machinery, the shops of the Milwaukee, the electric equipment, the copper wire in the electric transmission system, the 55 or more electric locomotives which are under this mortgage, you could build up a very substantial total value in relation to the nominal amount of bonds outstanding, and certainly the Northern Pacific, which is a competing and paralleling line could, in my opinion, well afford to pay certainly substan-
3237 tially in excess of the scrap value of these lines and acquire them for their system.

I don't think there is the slightest question as to the ability of the holders of the First and Refunding Mortgage Bonds to realize par if they can get at the assets.

Q. In addition there is a small amount of Bellingham Bay and British Columbia Bonds; they are not under the First and Refunding Mortgage, are they?

A. No, but they are also pledged with the Reconstruction Finance Corporation.

We hold $301,000 of them. They are a lien on some 60 miles of branch line, centering at Bellingham, Washington, a very important saw mill and lumber town on Puget Sound. Bellingham is not directly reached by the Milwaukee Rail Line, it is served by car float from Seattle.

And I believe that so long as the Western Lines of the Milwaukee are operated and continue to be operated as a part of the System, which presumably will be permanent, irrespective of the operating deficits, and mention has been made that it would be desirable to have access to these substantial tonnages of the Bellingham district, and part of that property would be kept in service, some part
3238 of it might be salvaged but there again the salvage would run two to three thousand dollars a mile, which would, with the value of the real estate, pay out a substantial part of these bonds, even on the—.

Q. (Interposing.). And there are only $301,000?

A. Yes, sir.

Q. Would it pay them out in full?

A. Quite likely, any discrepancy would be slight; I would say yes. In any event I feel that the first and refunding mortgage bonds have sufficient reserves.

Q. For the refunding of them?

A. For the refunding of them, and there is certainly sufficient margin on the first and refunding bonds to stand another $301,000.

Q. Now, Mr. Barriger, the record shows that the amount of these Bellingham Bay Bonds, in the amount of $301,000 which you have mentioned, became due in 1932; do you not know it to be a fact that to prevent the running the statute of limitations the R. F. C. brought within the period of the statute a bill for the foreclosure of the mortgage?

A. They did.

Q. Is still pending?

A. Yes, sir.

Q. One final question: Is the Reconstruction Fi-
3239 nance Corporation in your opinion, fully and adequately secured, both as to principal of and interest on all of the claims it now holds against the railroad, including both the loans made by the R. F. C. and the loans made by the P. W. A. and now held by the R. F. C.?

A. It is.

Q. And there has been in your opinion no time during this reorganization when if the securities could be reduced to possession, that the R. F. C. could not come out whole?

A. No time.

Mr. Clay: That is all.

Cross-Examination.

Q: (By Mr. Swaine.) Mr. Barriger, have you made a study of the Institutional Investors' Plan?

A. I don't know what you call a study, I have read it carefully several times.

Q. You are aware of the fixed charges and the contingent charges and its additions and betterments fund?

A. I am, yes, sir.

Q. And you are familiar with the earnings record of the St. Paul for the last several years?

A. Yes.

Q. You follow its present earnings from month to month?

3240 A. Yes.

Q. In your opinion does the Institution Investors' Plan afford an adequate financing medium for capital expenditures?

Mr. Clay: I object to that, Mr. Director. Mr. Barriger did not go into that subject on his direct examination, and it is out of order.

Director Sweet: The objection is good, it is not proper cross-examination.

Mr. Swaine: All right. I withdraw it on that basis. I concede it is not.

Q. (By Mr. Pantaleoni.) Mr. Barriger?

A. Yes, sir.

Q. In your study of the first and refunding mortgage and the collateral security, did you consider the pieces east as well?

A. No.

Q. You made no study of those?

A. None.

Q. No study of the bridge lines, but you made a study of the collateral, however, that was pledged?

A. Well, what do you mean by bridge lines?

Q. Well, some of those pieces east, but you did not go into any the pieces east?

A. No, I did not go into any of the pieces east, no.

3241 Q. Did you make any studies or come to any conclusion in regard to a severance value of the Western Lines?

A. No, I did not think that was necessary, it was so easy to see that you are adequately secured, even on the basis of salvaging the lines, that whether it had operating profit or did not was a matter of indifference for purposes of proof in this particular case.

Q. (By Mr. Burgess.) You have been talking about the first and refundings?

A. Yes, sir.

Q. You made no study of the 5's of '75?

A. No, sir.

Q. (By Mr. Pantaleoni.) Mr. Barriger, you made no study of the methods by which the operating deficit was determined as allocable to the lines west?

A. No, I did not.

Q. You just stopped there when you found an eight million dollar value or did you go on to find out how much there was left even on a scrap basis?

A. Why, we made no attempt to make a precise appraisal because it was so clear on the face of it that it was more than adequate.

Q. Substantially more?

A. In my opinion, yes.

Mr. Pantaleoni: That is all.

3242 Mr. Swaine: May I make Mr. Barriger my own witness now, for the purpose of asking that question. He is on the stand, and I think it would be interesting to have his idea as an expert in railroad finance problems, whether the Institutional Investors' Plan furnishes an adequate financing medium in the light of the past earnings record and the conditions that we now know?

Mr. Sweet: Is there any objection?

Mr. Clay: Well, if Mr. Barriger is prepared to answer it. In other words, have you read the Institutional Investors' Plan?

The Witness: Why, yes, I have.

Q. (By Mr. Clay.) But you have given it no detailed study?

A. I confess that I have studied the Plan more from the standpoint of the protection of the R. F. C.'s interest than those other aspects.

I have listened with great interest to the questions which Mr. Swaine asked on that point, and Mr. Walker's replies. I think I see the position of each in them. I can understand the reasons why the features were put, the protective features were put in the Plan, which Mr. Walker has there and to which Mr. Swaine has taken exception.

3243 Mr. Walker's Committee has evidently set up a corporate structure which they feel certain is going to be strong at the outset, they want to be very certain that it really is beyond the power even of the management to weaken it and they have set up controls in here which it is conceivable might be slightly more restrictive of the development of the property in periods of reduced earning power and still not have access to considerable sums of capital.

Mr. Swaine: Mr. Barriger, my question did not go to the restriction of the issue of bonds.

The Witness: Yes.

Q. (By Mr. Swaine.) I would like to strip it down to the bare question: Is a capital structure which provides for fixed charges commencing July 1, 1938, $6,556,000, then in additions and betterments fund of two and a half million dollars and then the contingent charges provision, irrespective of how the mortgage is drawn—

Mr. Burgess: You should let Mr. Barriger answer, you can't cross-examine your own witness.

Mr. Swaine: I am putting the question, if you will allow me to do so.

Q. (By Mr. Swaine.) Is that capital structure, irrespective of the question of restrictions in the mort-
3244 gage, a capital structure which would afford an adequate financing medium?

A. Not under the current level of earning power.

Q. Or on the level of earning power that prevailed in 1930?

A. Well, over that period there are several years in there of virtually complete loss of earning power, which would pull the average down.

Q. Do you feel that bonds could be sold under your first mortgage under present conditions?

A. No, I do not.

Mr. Swaine: That is all.

Q. (By Mr. Burgess.) What do you mean by present conditions, Mr. Barriger?

A. Well, I mean that under present circumstances the Milwaukee's income available for bonds is running substantially below 1937. Last year I believe they were—

Q. That is what I was driving at; you mean today, or back of 1938?

A. Last year they had about $9,000,000 available for bonds. This year the way things are running now they might have anywhere from two to five million. I am disregarding the possibility of the freight rate increases, but taking it on its present level the Milwaukee—

3245 Q. You are talking about January, 1938?

A. Yes.

Q. With the wage increase in effect and with no rate increase in effect?

A. The Milwaukee along with a good many other railroads has seen its earning power disintegrate.

Q. (By Mr. Clay.) Mr. Barriger?

A. Yes.

Q. Is the Milwaukee an exception to the situation of many other railroads?

A. No, unfortunately, it seems to be the rule.

Q. In other words, has not the capital market been closed to railroad bonds for some months?

A. Yes, only a few of the most fortunately situated railroads.

Q. Do you know of any railroad bonds that have been sold since November?

A. I know of none.

Q. Not even equipment trusts?

A. Well, the Santa Fe has sold some equipment trusts.

Q. It isn't reasonable, is it, Mr. Barriger, that that condition will continue without some change for the better or for the worse?

Director Sweet: I think we have gone about far enough with the subject.

3246 The Witness: Well, some change for the better has got to come.

Mr. Clay: In other words, the condition since November can be reasonably considered a temporary condition?

The Witness: We must consider it temporary, yes, sir.

Mr. Clay. That is all.

Director Sweet: You are excused.

(Witness excused.)

Director Sweet: We will be in recess now until nine-thirty o'clock tomorrow morning.

(Whereupon, at 5:05 o'clock p. m. an adjournment was taken until 9:30 o'clock a. m. of Friday, February 4th, 1938.)

3248 Hearing Room B,
I. C. C. Building,
Washington, D. C.,
Friday, February 4, 1938.

Hearing in the foregoing matter resumed at 9:30 o'clock, a. m., pursuant to adjournment.

Before:

Director O. E. Sweet, and
Examiner M. S. Jameson.

Appearances:

The same as heretofore noted.

3250 PROCEEDINGS.

Director Sweet: Proceed.

Mr. Orschel: I would like to call a witness, Your Honor.

Director Sweet: Very well.

WILLIAM W. WAKEFIELD, was sworn and testified as follows:

Direct Examination.

Q. (By Mr. Orschel.) Will you please state your name and address?

A. William W. Wakefield, 2457 Prairie Avenue, Evanston, Illinois.

Q. State your occupation.

A. I am a civil engineer.

Q. Please state your relationship to the preferred stockholders' committee of the Chicago, Milwaukee, St. Paul & Pacific.

A. Technical adviser.

Q. Please state your business experience, Mr. Wakefield.

A. My experience as a civil engineer from 1900 to the present time has largely been in the service of railroad companies in their engineering departments, on location, construction and maintenance work.

Q. What have been the specific duties of your work in this connection?

3251 A. The duties involve various position on location survey parties, the position of resident and division engineer on railroad construction projects, and as an assistant engineer handling all phases of maintenance work on steam railroads, with the responsibility of maintaining safe tracks and structure.

Q. Have you had any experience with railroad financial problems?

A. In my services with the railroads I was not connected with the financial offices, but was connected with the valuation of railroad properties from 1913 to 1938. This involved inventory of physical units, research in original cost, status of reproduction costs, and inspection of physical properties to determine depreciation.

After 1928 I was associated with a consulting engineer in valuations of steam railroads and utilities in connection with rate cases, also made bankers' reports and financial statements of utilities for purchasers and sellers of the properties.

In 1936 and 1937 I was associated with the firm of Duff and Phelps, security analysts, in the City of Chicago, and made investigations and road reports on a large number of steam railroad systems for the use of the investors.

3252 These reports involved the study of the financial status of each of these properties, consideration of the capital structure, the condition of the properties and the relationship between capital investments and earnings.

Q. What railroads were included in connection with these reports?

A. The Chicago, Milwaukee, St. Paul & Pacific Railroad, the St. Louis-San Francisco Railroad, the Illinois Central Railroad, the Baltimore & Ohio Railroad, the Alton Railroad, the Missouri Pacific Railroad, the Gulf Coast Lines and the International-Great Northern.

I also made a report for H. H. Copeland & Sons, of the Chicago & Western Indiana Railroad and the Belt Railway of Chicago.

Q. In connection with your experience and with activities with the railroads, themselves, state, if you will, the railroads for whom you have previously worked.

A. My first railroad experience was on the construction for the Chicago & Great Western Railroad on the line from Ft. Dodge to Omaha. I then was with the Great Northern Railroad, the Northern Pacific, the Chicago, Milwaukee & St. Paul, the Minneapolis, St. Paul, Roches-

ter & Dubuque Electric Traction Company (the Dan Patch Line), and the St. Paul Southern Electric Railway
3253 Company, on construction and maintenance projects.

I was then connected with the Minneapolis, St. Paul & Sault Ste. Marie Railroad, the Northern Pacific Railroad and the Elgin, Joliet & Eastern Railroad, on valuation matters.

Q. Mr. Wakefield, will you explain the nature of your work as technical adviser for the preferred stockholders' committee of the Milwaukee Railroad?

A. I was retained by this Committee at the time they received the plan of reorganization submitted by the institutional investors, to make a study of the factual information with respect to that plan. In that connection the report made on the Milwaukee Railroad early in 1937 was called to the attention of the Chairman of the Committee for the preferred stockholders, and it was his idea that some use should be made of the investigations which had been made for this report.

Q. You mean the report made by yourself?

A. Yes. As technical adviser for this Committee, I have endeavored to compile the operating and physical features of the Milwaukee Railroad to show the present conditions of this property.

Comparisons of the volume of traffic revenues, expenses and net results were compiled to show the present
3254 degree of efficiency of the railroad enterprise.

Q. To what extent did the previous report which you had made on the Milwaukee Railroad serve you in connection with this work which you undertook?

A. In the preparation of the report made early in 1937, I made a thorough investigation of the records of the company in all phases of operation, made an inspection trip over nearly all of the main line, and visited shop locations to determine methods employed in shop and locomotive repairs and construction.

In the studies made special attention was given to the debt structure and finances of the company. In the studies of finances I was assisted by Mr. Evans Ausman and Mr. George Phelps.

The study of finances involved the study of the management plan of reorganization made in 1935. My studies in connection with this report covered a period of three months.

Q. In connection with the work which you have been

doing for the committee, please state how and where you carried on your work.

A. The work done for this committee was carried on in the offices of the Milwaukee Railroad in Chicago and the original company records were made available
3255 upon request. All of the information to which reference is hereinafter made was compiled from an examination of the original records.

Q. In connection with the report made on the Milwaukee Railroad by you, and your subsequent studies now, will you state the facts reflecting the nature of the operations and the condition of the physical properties of the road?

A. The inspection of the properties and the study of Milwaukee records reflected a well-maintained railroad with a progressive policy of operation. The track structure has been constantly bettered since 1928, by the application of heavier rail where necessary, and additional signal installation and ample tie replacements. This is disclosed by the train speed limit on the various lines, which in general has been increased from 45 to 60 miles per hour maximum on main lines, to a normal speed of around 100 miles per hour, except for bad curves—on the same lines, while branch line speeds have been increased from 30 to 40 miles per hour limits to 60 and 70 miles per hour.

This track condition has been obtained during a depression period, by methods employed by this management to overcome deferred maintenance even though revenues were reduced.

3256 To obtain this result the management departed from ordinary methods of maintenance to their new method designated as "mass maintenance methods." This method involved the changing of cycles for tie renewals from yearly replacements to approximately five-year periods.

Large extra gangs, equipped with power tools, were used of from 150 to 250 men in each gang, divided into specialized groups for removing ties, placing new ties, tamping ties, etc., and completely rehabilitating the entire track structure on an entire line in one season.

The reduction in cost per mile for labor and work-train service under this program was remarkable. As an illustration:

In the year 1926, the first year when large gangs were used, the cost per mile for labor and work-train service to lay rail was $922.28. Incidentally I might add that that

was a test period. The low point was reached in 1932, when the cost was $370.35, though this labor cost reflects a 10 per cent decrease in labor rates, and in 1936, with the wage rate restored, the cost amounted to $443.83 per track mile laid.

This was true also of ballast, ties, tightening bolts, and dressing track.

3257 In my investigation of other railroads, the cost of the same type of work compares favorably with the Milwaukee costs before mass maintenance methods were installed, and in connection with my report on the St. Louis-San Francisco Railroad I discovered that their cost to relay rail was approximately $1000 per mile. At my suggestion they investigated the Milwaukee methods, and it is my understanding that the use of mass maintenance methods for relaying of rail in 1937 reduced the Frisco Lines' cost to about $600.

Since mass maintenance methods have been employed all of the tracks of this company have been covered under mass methods on tie replacements and renewing ballast. 1669 main track miles have treated rail ends, and the condition of the track has allowed a reduction in the number of section crews from 1554 in 1929 to 941 in 1936, and the average number of laborers per section is now one laborer per section during the winter months, and three laborers during the working season.

The maintenance of equipment is now on the basis of from 12 per cent to 14 per cent of gross revenues, and locomotive and car repair shops are now prepared to increase or decrease activity to conform to revenue.

3258 Under this plan of 12 to 14 per cent of gross revenue, all safety devices recommended by the Association of American Railroads have been applied, and the order of the Interstate Commerce Commission for the installation of power reverse gears will only involve an expenditure of about $200,000 in the next four years.

Equipment condition is not only bettered, but considerable savings were effected in the construction of new cars and locomotives constructed in the company's shops.

The Milwaukee Railroad has rated No. 1 of Class I railroad in the efficiency of fuel for a number of years.

It will be of interest to note that steam locomotive repairs per tractive effort pound were reduced from 26.02 cents in 1920 to 18.01 cents in 1925, and to 10.16 cents in

1935, and unserviceable locomotives was reduced from 14.6 per cent in 1920 to 10.1 per cent in 1935.

Freight car maintenance reduced the unserviceable cars on line from 7.8 per cent in 1925 to 2.9 per cent in 1935, while the cost of repair per car decreased from $163 in 1925 to $53 in 1935.

The cost of conducting transportation was 30.85 cents in 1925 and was reduced to 23.57 cents in 1935, though
3259 the average net ton per train mile was reduced from 714 in 1925 to 650 in 1935.

Similar reductions have occurred in the cost of handling l.c.l. freight from 67.21 cents in 1929 to 59.81 cents in 1935, and switching service was reduced from 35.37 cents in 1930 to 34.41 cents in 1935.

A comparison of transportation expense for the year 1935 shows a ratio of 26.48 for the Milwaukee, 24.69 for the Burlington, and 35.14 for the North Western Railroad.

This, of course, reflects extremely severe weather for the Milwaukee and North Western.

In the month of February transportation ratios were 71.59 on the Milwaukee, 90.84 on the North Western, while the Burlington, not being subjected to the snow conditions of the other two roads, had a transportation ratio for the month of February of only 37.43.

Payrolls of the Milwaukee Railroad amounted to $84,745,215 in 1925, with a total of 52,506 employees. In 1935, under the same basic rates, the payrolls of the Milwaukee amounted to $48,382,110 for an average number of 30,109 employees.

This reduction is largely due to the economies in maintenance of both track and equipment, though the increased volume of traffic would require almost a proportionate
3260 increase in labor costs in transportation expense.

Overtime payments were reduced from $5,688,313 in 1929 to $2,170,687 in 1935. This is largely due to improved schedules with transportation employees and better coordination of train service.

The passenger operation of the Milwaukee Railroad requires service in nearly all lines. However, the competitive service is between Chicago and Milwaukee, Chicago and Green Bay, Wisconsin, Chicago and St. Paul and Minneapolis, Chicago and Kansas City, Chicago and Omaha, Nebraska, Chicago and Sioux City, and Chicago and Seattle and Tacoma.

The difference in mileage between Chicago and Seattle

of the Milwaukee, Northern Pacific and Great Northern, is very slight, while the difference in mileage between Chicago and St. Paul and Minneapolis, is about the same for the North Western and the Milwaukee, though much less than the Burlington, Great Western and Soo Line.

The Milwaukee has the short line between Chicago and Omaha. The mileage between Chicago and Sioux City is practically the same on the Milwaukee, North Western and Illinois Central.

The Milwaukee mileage between Chicago and Kansas City is only exceeded by the Rock Island and Great
3261 Western Lines, but is 57 miles longer than the Santa Fe line.

The Milwaukee serves their traffic with one train between Chicago and Seattle and Tacoma, called the Olympian. This is in direct competition with two trains each on the Great Northern Railroad and the Northern Pacific Railroad, and speed service on the Hiawatha medium weight steam train between Chicago and St. Paul and Minneapolis is in direct competition with the speed service of the "400" on the North Western and the Zephyr service on the Burlington.

In addition to the speed service, the Milwaukee furnishes an over-night service with their Pioneer Limited train in this territory. They also operate 36 passenger trains daily between Chicago and Milwaukee. There is a schedule of 90 minutes or less for the 85 mile run for sixteen of these trains, and twelve are completely air conditioned.

It is of interest to note that the schedule of the Hiawatha between Chicago and Milwaukee, completing the 85 mile run in 75 minutes, is the fastest train service in the world.

The speed service of the Hiawatha was inaugurated late in 1935, and met with public approval.

The revenue from this train amounted to $1,800,000
3262 for the year 1936, with an expense, including depreciation of equipment, of about $800,000, making a net return of nearly $1,000,000.

Similar train service was placed in service in the summer of 1936 from Chicago to the North Woods, and this train netted a small profit.

In 1937 speed service was inaugurated between Chicago and Upper Michigan points on the Milwaukee, and a competitive service was established on the North Western by the installation of their Flambeau train.

Speed service was also installed in a connecting train

to Mason City, Iowa. Both of these trains showed a slight profit in the short period operated in 1937.

It is interesting to note that the installation of the Hiawatha did not detract from the over-night service on the Pioneer Limited, and the operation of the Olympian in the same period produced a revenue equal to the out-of-pocket cost.

It is my understanding that other de luxe service will be placed in service on the Omaha and Kansas City lines. Tracks have been aligned and curves surfaced for high speed service on both of these lines.

Branch line passenger service has suffered heavily from bus operations, but it has been somewhat demon-
3263 strated that air conditioned trains will regain some of this service.

The Sioux City, Aberdeen Line passenger service has shown considerable improvement in revenue since 1937. Head-end revenue from mail and express showed some increase in 1937 over 1936. Passenger revenues reached their low point on the Milwaukee Railroad in 1932, with $14,596,000 earned. Suburban service out of Chicago on the Milwaukee is small, and while future developments in the Chicago area may have some effect, it is my opinion that this service will never assume major proportions.

3264 Q. Mr. Wakefield, will you state whether the 1937 operations reflect in any way the efficiency and operation to which you have just called attention? I think you have some charts prepared in connection with that.

A. A study of the revenues and expenses of 1937 and 1936 was made, and this study necessitated the adjusting or restating of revenue to the 1936 base. To do that it was necessary to have some relationship between the 1936 and 1937 volume.

The total carloadings in 1937 consisted of 1,472,883 cars; while the 1936 volume, in the same terms of carloadings, was 1,484,853 cars, a difference of 11,970 cars. Actual tonnage statistics were not available and these carloadings were taken as an indication of volume.

Q. I do not think it is necessary to go into detail, Mr. Wakefield. You might just state your conclusions and how you reached them. I would not take the Commission's time further on it.

A. In restating the revenues that would have been received under the same basis of rates as received in 1936, ten

months carloadings were used and revenues by com-
3265 modities. It was restated and the result would have been an increase in revenue of $3,141,000, which would have made the total revenue for 1937 under this basis $110,778,000, with practically the same volume, or at least only a slight difference in volume in carloadings between the two years.

Q. So that it is your opinion, as a result of the manner in which the railroad is being operated, had conditions remained the same, which of course, they were not, these results in efficient operation would have been reflected in increased earnings. Is that correct?

A. Well, you would have gone further, and taking their expense account on it under the basis restated, including this $3,141,000, the income available for interest in 1937, including wage increases that year paid, would have been $11,899,000 as against $9,743,000 in 1936.

Q. Will you state, Mr. Wakefield, whether, in your opinion, it is possible to forecast with any degree of certainty passenger operations in the immediate years to come?

A. It is my opinion that the result of passenger operations will result in an increasing revenue in future years.

This is based on the low fares now in effect, the im-
3266 proved equipment, particularly air conditioning and streamlined speed trains, and the increasing congestion on highways. However, it is extremely difficult to forecast the rate of this increase.

Q. Will you kindly state, Mr. Wakefield, what your examinations indicated to the freight operations conducted by the Milwaukee Railroad?

A. Freight operation on the Milwaukee Railroad has been materially changed since 1935. This change consists largely of speeding up service, and is obtained by faster road running time and prompt handling of freight in terminal and division yards.

Train capacities have been increased by the purchase of new power equipped for the speedy handling of heavy loads, and with increased capacity for coal and water to enable longer runs without stops.

Thirty units of this type of new power are being installed in the early part of 1938. The building of lighter weight freight cars, combined with this new power, will increase the length of trains and the tons of revenue freight handled per train.

It is recognized that if the Train Limit Bill is enacted, this will seriously interfere with the efficiency of this new power, but the point is mentioned to show that so far
3267 as mechanical development is concerned, the operation has been forward-looking.

The installation of this new equipment will produce economies on the heavy freight lines. The heavy duty freight lines, consisting of the line from Chicago to St. Paul, Chicago to Omaha, Chicago to Kansas City, the River Division from Savannah to La Crosse, and the Terre Haute line, handles the bulk of the tonnage on the Milwaukee Railroad.

However, these lines are dependent on the secondary lines consisting of the Southern Minnesota and Northern Iowa lines and the connecting lines in Wisconsin.

The loadings on the lines from Minneapolis to Seattle, Aberdeen to Sioux City, and the Judith Basin Lines are dependent on industrial activity and agricultural production.

Fluctuations in traffic do occur on these lines. The branch lines now in service on the Milwaukee Railroad are serving a feeder purpose for main line haul, and it is my opinion that very little economy can be expected by abandonment of any of these lines.

Q. Will you kindly state whether, in your opinion, it is possible to forecast with any degree of certainty freight operations in the immediate years to come.

A. The traffic in 1935, 1936 and 1937 does not, in
3268 my opinion, form a criterion of future freight volume.

As an illustration: a new type of freight was obtained in the early part of 1937, consisting of fir pulpwood, being received at West Coast points for delivery to Wisconsin paper mills.

This was the result of a chemical test determining that fir pulpwood could be used in the manufacture of paper. The labor disturbances in the coast states in the lumber industry stopped the flow of this traffic in the last six months of 1937, but the future development of this industry should produce an all-year business of sizable proportions.

The Grand Coulee Dam now being constructed by the United States Government contemplates an irrigation project for nearly all of the desert region between Spokane and the Columbia River.

The Milwaukee main line bisects this area and a development of fruit producing in this territory will create a new

commodity to the Milwaukee similar to the same industry now served by the Northern Pacific in the Yakima Valley and the Great Northern in the Wenatchee Valley.

It is difficult to estimate the extent of this traffic. The Milwaukee Railroad constructed 30 miles of a branch
3269 railroad in Idaho in the last few years, serving a timber area that is estimated to be productive for the next twenty years.

Q. With reference to the plan of reorganization submitted by the Institutional Group, the estimate is made that the normal gross revenue will be $126,900,000 per year, and the net revenue will be $15,696,000. Will you kindly state whether, in your opinion, these estimates are correct or can be fulfilled?

A. It is difficult to forecast revenues from the preceding years of operation as the future volume of traffic is dependent upon the industrial situation, and crop production dependent upon weather conditions. The income available for fixed charges is entirely dependent upon the revenues obtained. The uncertainty of conditions at the present time with volume of traffic decreasing since the middle of 1937 makes the forecast of a normal year almost impossible.

However, the plan does forecast a normal year's revenues as $126,900,000 and the income available for fixed charges is $15,696,000, and with this income figure used as the base in the plan, as a probable income to be used
3270 from normal operations, it is well to consider the ratio of income to revenue on these figures.

The income available for fixed charges of $15,696,000 shown in the Institutional Investors' plan, as taken from Exhibit No. 121, does not reflect a correct statement in the plan that increased costs due to wage increases would be offset by increased rates.

Under the assumption that wage increases, Social Security taxes and increased material costs were included in these increases costs and the basis of Exhibit No. 121 based on tariff rates, wage and material prices as of June 30th, 1937, the income available for fixed charges of $15,696,000 was decreased by the inclusion of $1,023,000 of Railroad Retirement excise tax and Social Security Unemployment tax and an undetermined amount for increase in the cost of materials and supplies.

Therefore, the income available for fixed charges would be increased to at least $16,719,000.

Exhibit No. 96, made in 1935 by the management, estimated the 1939 revenue at $121,000,000, with income available for fixed charges would be $17,800,000. This estimate was not complicated by decreased rates and increased wages, materials and taxes.

3271 A consideration of the increase of net with a given increase in gross income on the basis of 1937 operations, compared with the 1939 estimated in Exhibit No. 121, was made with the estimated gross revenue at $126,900,000.

The 1939 estimate shows maintenance of way expense at $19,000,000 as compared with $18,000,000 in 1937.

The $18,000,000 expense in 1937 included the increase of wage scales for the last few months of 1937 and increased material costs during the entire year.

These increases were partially offset by the reversal of charges, creating a credit in the 1936 charge for the Railroad Retirement Act.

It is conceded that with the increased volume of traffic producing $126,900,000 total revenue, that maintenance of way would be slightly increased, and the estimate for 1938 of $19,000,000 is not unreasonable.

It is my understanding that the increase of $1,000,000 is largely due to the consideration of increased material costs. It is the plan of the management to hold maintenance of equipment expense at from 12 to 14 per cent, 14 per cent was used in the 1939 estimate.

3272 Depreciation and all other expenses remain fairly constant, and the 1939 estimate of $6,014,000 for depreciation and $7,700,000 are obtained from actual data.

Transportation expense varies with volume and is estimated from 35.5 per cent of total revenue when that revenue amounts to $141,000,000 in 1941 and 37.1 per cent of the total revenue of 1937.

The 1939 estimate of $45,920,000 is about 36.2 per cent of the total revenue. It will thus be seen that maintenance of equipment remains at a constant of 14 per cent and transportation expense remains at about 26 per cent.

Other expenses remain constant. Therefore, with an estimated gross revenue of $107,600,000 produced in 1937, an increase of $19,300,000 in total revenue would be received.

With maintenance of way expense, depreciation of equipment expense and all other expenses remaining constant,

and the variable expenses of 14 per cent for maintenance of equipment and 26 per cent for transportation expense, increasing expenses 50 per cent, that $9,650,000 of the expense would be carried to net.

The income available for fixed charges in 1937, 3273 amounted to $9,868,000 and with the increase of $9,650,000 in net from the larger volume estimated, the income available for fixed charges out of $126,900,000 total revenue would amount to $19,518,000, after including $1,023,000 increase in expense for new retirement and unemployment taxes.

Assuming that the plan of reorganization estimated that wage increases and these taxes would be compensated by increased freight rates, the income available for fixed charges would be $20,541,000.

Therefore, the income available for fixed charges of $15,696,000, used as a basis for determining the capital structure under reorganization, should be increased to some figure between $16,719,000 and $21,541,000.

Q. Is it your opinion that the net revenue can be increased through other sources or by other devices?

A. In the limited time available, a preliminary investigation was made in regard to additional savings in revenue contemplated by the management through the coordination and joint use of these and other railroad facilities.

Twenty-six coordinations have been effected between 1929 and the present time, resulting in an estimated saving of over $500,000 annually with the Milwaukee proportion amounting to an annual saving $261,524. 3274

These coordinations consisted of joint main track usages on eleven different projects. Preliminary studies and investigations were made by the management on 108 additional projects that have been temporarily dropped as disclosing no immediate saving, or the projects are impractical on account of physical conditions.

I have prepared a statement of coordination projects to be considered. This involves 85 projects and preliminary estimate of savings has been made by the Milwaukee management on these 85 projects showing an appropriate annual saving of $1,869,400 of the Milwaukee proportion, or somewhere around $750,000.

Q. Will you state what the type of those coordinations are?

A. The types of facilities considered in these coordinations consists of joint use of bridges, freight stations, sta-

tions and yards, passenger and freight terminals; pooling of traffic, and the larger projects that were considered are as follows:

Aurora, Illinois, station and yards; Cedar Rapids, Iowa, all facilities; Clinton, Iowa, terminal facilities; Council Bluffs and Sioux City to Chicago, pooling of east-
3275 bound through freight; Davenport, Rock Island, Moline and East Moline, terminal facilities; Deming to Bellingham, Washington, main track usage; Des Moines, Iowa, Terminal facilities; Freeport, Illinois, terminal facilities; Great Falls, Montana, terminal facilities; Green Bay, Wisconsin, terminal facilities; La Crosse, Wisconsin, terminal facilities; Mankato, Minnesota, terminal facilities; Missoula, St. Regis; main tracks; Pastville, to Decorah, Iowa, main tracks; Rockford, Illinois, all facilities; Sokane, Washington, terminal facilities; Terry-Forsyth, Montana, main tracks; Three Forks to Butte, Montana, main tracks; Tunnel City—Medary, Wisconsin, main tracks; Wisconsin Rapids, Port Edwards and Nekoosa, Wisconsin, main tracks.

These coordinations involve agreements with the North Western, Northern Pacific, Great Northern, Soo Line, Illinois Central and Rock Island Railroads.

In addition to the projects now considered by the management, it is my opinion that other coordinations should be considered. I know of three that in my opinion would produce savings, consisting of the use of the Milwaukee main line from Polo, Missouri to Muscatine, Iowa, by the Rock Island Railroad; the pooling of traffic between
3276 Council Bluffs, Iowa and Sioux City, Iowa, where traffic rights by the Milwaukee over the North Western Line would be involved, which would shorten the Milwaukee haul from 150 to 100 miles; and joint traffic on the Rapid City Line, contemplating the abandonment of either the line of the Milwaukee or the North Western Line for approximately 100 miles.

Does that answer your question?

Q. I think you had a prepared statement there, if you will complete it, Mr. Wakefield.

A. That ends it, does it not?

Q. In connection with the last page I mean, your prepared statement which you have prepared?

A. What page is it.

Q. I have a copy of it here.

A. There has been considerable public discussion by government officials concerning the problems of the railroads in general and particularly the problems of those which operate in the Mississippi Valley, and it has been suggested that one of the solutions may be a consolidation, and there has been further public discussion of a possible consolidation between the debtor in these proceedings and the Chicago and North Western Railroad.

3277 It has been pointed out that there is extensive paralleling of lines and substantial amounts of traffic of both railroads move between the same terminal cities. It seems to this Committee that this situation is worthy of serious consideration by the Interstate Commerce Commission in connection with any plan of reorganization of either line.

Obviously, statistical information concerning economies which might be effected through a merger will require exhaustive study—which this Committee has not had an opportunity to undertake.

We are authorized to say that the Protective Committee for the Holders of the Common Stock of the Chicago and North Western Railroad share the view that the Interstate Commerce Commission should give consideration to such a consolidation in any plan of reorganization for the Chicago and North Western Railroad, and that no plan of reorganization should be proposed until the feasibility of such a merger is thoroughly explored.

We are further authorized to say that the Protective Committee for the Holders of the Common Stock of the Chicago and North Western Railroad have expressed their willingness of participating in a joint study of this phase of the reorganization of the two railroads—which

3278 this Committee is also desirous of doing.

If such studies indicate that a merger is practical, both Committees will devote themselves to the task of presenting a plan to embody such a proposal.

Q. Mr. Wakefield, will you state whether in your opinion, the plan is fair and equitable, and your reasons in connection therewith? I think you have a memorandum in writing there.

A. This one here?

(Producing paper.)

Q. Yes, sir.

A. I was wondering if there was anything further?

Q. No, sir, you have covered everything in your prepared statement.

A. Whether this debtor should submit to a sweeping reorganization, in a year of uncertainties, the aim being to design a financial structure, capable of resisting further temporary depression of its earnings, and to attract capital which it has no over abundance of at this time, is not a question of public interest, raised in this proceeding.

This road has good management, its property is well maintained, its equipment compares favorably with
3279 any of our modern and well financed carriers, its ability to render adequate service has not been questioned.

Likewise its ability as constituted to render adequate service, in greater volume and pay its operating costs for some time to come has not been challenged.

On the contrary, the real interest here and now is confined to those whose funds are invested in this carrier.

If serious consideration is given to the following facts:

First, that the carrier possesses facilities to profitably handle a much larger volume of business and to admit this as a possibility is only to point to the volume that it has enjoyed historically, and:

Second, that coordination of a type to suit modern methods are available and will eliminate expense without surrendering the carriers ability to solicit business.

Third, if the now public expressions for consolidations or mergers represents opportunities that will in the course of time constitute accomplished actualities then any reorganization under the plan will deprive forever those
3280 whose funds are invested in junior securities from a participation in these betterments.

Since the interested parties are only the investors therein, it surely follows that unless some compromise to the plan which admits that their holdings have some value in the future can be agreed upon then no real and final loss can accrue to those in a senior position by waiting until the more reasonable future can be ascertained by actual experience.

Mr. Orschel: That is all, your Honor.

Mr. Burgess: No questions.

Director Sweet: Does anybody want to cross-examine the witness?

(No response.)

Director Sweet: You may be excused, Mr. Wakefield.

(Witness excused.)

3281 Mr. Pantaleoni: I represent Mr. William Church Osborn, who has intervened in this proceeding, representing and owning substantially in excess of $1,000,000 principal amount, of the Five's of 1975.

I am prepared at this time to call only one witness, and that witness is prepared to testify on only one very small part of what would ordinarily constitute a case for the holders of the Five's of 1975, in opposition to this Plan.

The Witness is Mr. George Parker, who has made a two weeks' examination, at the company's offices, of the basis and the facts upon which the formula, which is in effect, and is now before the Commission, reflected in Exhibits Numbers 139 to 146, is based.

Mr. Parker is prepared to show that the facts which are not now in the record, the facts upon which that formula is based, are largely, if not in whole, assumptions and guesses.

He is also prepared to show that a more detailed and sufficiently accurate survey of the allocation of revenues and expenses to the lines covered by the First and Refunding Mortgage could be made at small expense, and within a reasonable time.

He is also prepared to show that based upon his examinations, if such a survey is made, it will show,

3282 first, that the lines west, and pieces of lines east have produced in the year 1936, not a deficit, but on the contrary those lines are a self-sustaining system.

He is also prepared to show that his study indicates a very real value to the collateral pledged and the security under the first and refunding mortgage.

Now, that would constitute only a small part, and because I am unable to call additional witnesses on other vital parts of this proceeding, I do not wish to be taken as resting our opposition to the Plan solely upon the improper allocation set forth in the Plan.

On the contrary, if we have sufficient time, and if the Commission will take proper action, as I see it, on the motion already made to grant us a reasonable adjournment, I should hope that we would be able to show a great many other things.

There is no testimony now in the record with regard to severance value, with regard to the contributed value, and with regard to a great many other elements.

And I believe there is inadequate evidence before the Commission with regard to the feasibility of the Plan.

3283 True, there is a great deal of that evidence presented by the proponents of the Plan, but the opposition has had pretty short time.

Mr. Parker.

GEORGE H. PARKER, was sworn and testified as follows:

Direct Examination.

Mr. Pantaleoni: While you are opening your bag, Mr. Parker, this is not the first time you have testified before the Commission as an expert, is it?

The Witness: No, sir. There have been quite a number of occasions in the past.

Q. (By Mr. Pantaleoni.) Will you state your qualifications as an expert, concisely but fully?

A. My name is George H. Parker, a Consulting Accountant, with Office at 143 Liberty Street, New York, and I also have an office at 729 15th Street, Washington, D. C.

Since 1921 I have engaged in private practice as a consulting accountant, chiefly dealing especially in transportation matters. Lately I have been engaged on a report for the Trustee of two Mortgage Properties of the Rock Island System in connection with the pending Rock Island Reorganization Proceedings before this Commission.

3284 I have also lately been engaged on two or three State Rate Cases, and two Rate Cases before this Commission which are now pending.

Just prior to that I was consultant on the staff of the Federal Coordinator of Transportation, for a little over a year, my work in that position being especially in connection with the study of Branch Line Operations, and because of the critical position of the Roads in the Northwest and the West, we concentrated pretty largely on that area.

Also in that consulting capacity I made some studies of the Rail-Highway Coordination, and that inquiry took me on to the New York Central, the Pennsylvania Railroad, the Boston and Maine and the Cotton-Belt. I think there were some other casual inquiries as to some other roads which I do not recall in detail now.

Q. Does that complete your qualifications?

A. No, sir.

Q. Proceed.

A. Just prior to that I made a report for the Royal Commission on Railways and Transportation of the Dominion of Canada, of the whole Canadian Railway System, and also the subject of the Dominion Finances in general.

3285 That job took me about a year, and resulted in two reports, one of one-hundred and fifty pages and one of two-hundred and fifty pages, with a very great volume of appendices.

Just before that I was a witness and of counsel in the so-called Lighterage Case before this Commission, in which I appeared in behalf of the City of Boston Port Authority, which involved the question of the reasonableness and the prejudicial character of the rates to and from New York as compared with the rates to and from Boston.

Just prior to that, in 1930-1931, I made a report for the New England Governors' Committee on the New England Transportation situation, and rendered that Committee a very voluminous report with reference to the New England Transportation situation, including not only the operation of rail lines, but also the water lines and bus and truck situation.

During the period that I was engaged on this work for the Royal Commission, the Lighterage Case, and the Governors' Committee, I made a report for the Commonwealth Fund of New York, in association with Professor Walter Dodd, who at that time was Professor of Law at Yale University, of the law and the experiences of the carriers and labor under the Federal Employers Liability

3286 Act. When I say "in association with Professor Dodd," he was giving attention to the operation of the Workmen's Compensation Statutes throughout the several States, so that part of it which dealt with the Federal Employers Liability Act was my part of the job, and that study took me on to the New Haven in quite an extensive way, the Pennsylvania Railroad to quite a limited extent, to a considerable extent on the Baltimore and Ohio, the Atlantic Coast Line, the Burlington and the North Western. Those are all I can recall at the moment.

Just before that I made a Cost Study for two of the Canadian Provinces of the cost of transportation of coal from Alberta into Ontario, and in the ten years preceding that I was in quite a number of cases, mainly before the Interstate Commerce Commission.

For example, I was an expert witness for the Virginia, West Virginia, and Kentucky Operators in two of the Lake Cargo Coal Cases. I was a witness for the Norfolk and Western in the case involving the proposed lease of the Virginian Railway Company. I was a witness for the Pullman Company in a case involving the establishment of some accounting principles before the Interstate Commerce Commission.

I was a witness for the Southeastern Railroads in
3287 the Florida Perishable Case, which involved the preparation of a study of the cost of movement of Florida Perishables, and in comparison with the cost of other commodities, not only on the Southeastern Railroads, but also generally throughout the Eastern territory.

I also was either a witness or counsel in quite a number of Division Cases, in which I represented quite a number of Short Line Railroads before this Commission, including the Spokane Eastern, the Sewell Valley, the Wildwood and Deleware Bay Short Line Railroad Company and the Salina and Northern.

I was consulted by both the anthracite operators and the anthracite carriers in the Coal Cases that were before the Commission, and I was also a witness or of counsel in about a dozen or fifteen valuation cases, including the Wildwood and Delaware Bay Short Line Railroad, the Raritan River Railroad, the Limerock Railroad, the Lake Erie, Franklin and Clarion, the Middletown and Unionville, California, Nevada and Oregon, Northampton and Bath, the Hannibal Connecting, and I was in or handled a number of financial matters of which I recall the Virginia Central, the Warrenton Railroad, and also some other railroads which I have mentioned in connection with the Divisions Cases or Valuation Cases.

3288 I also appeared in behalf of the Short Line Railroads before a number of Congressional Committees in connection with transportation matters, in connection with the repeal of the Recapture Clause, Section 15 (a), and the settlement of matters growing out of the Federal Control of Railroads.

Director Sweet: Have you had experience in any of these connections with the Milwaukee Railroad?

The Witness: The Spokane and Eastern Rate Case—and I may say that in connection with the Branch Line Studies of the Coordinator, we had data from the Milwaukee in quite an extensive way.

Director Sweet: The records of the Commission show, of course, your participation in a great many of these cases?

The Witness: I beg your pardon?

Director Sweet: The records of the Commission show, of course, your participation in a great many of these cases?

The Witness: These which I have mentioned will be shown, wherever I entered an appearance, but where I appeared as a witness, I guess in all cases the reports of the Commission do not refer to the individual witness by names, but simply says a witness for Protestants, or Complainants, or whatever it might be.

3289 Director Sweet: The transcripts, briefs, and things of that sort will show it?

The Witness: They would show it.

Director Sweet: Do you not think you have stated your qualifications pretty fully by this time?

The Witness: Well, sir, I would like to say just a few words, if I won't transgress on the time of the Commission, just to go back a little bit into it. I will say that I handled the claims of the Short Line Railroads, under Section 209 of the Transportation Act, 1920, and prior to that I was Comptroller of the Philadelphia and Reading Railroad for about two years; was Financial Assistant to the Director General of Railroads, and later Comptroller of the United States Railroad Administration.

Prior to that I was Assistant Vice President of the Delaware and Hudson Company for about six years, during which time I was a member of the Committee on a number of important matters for the carriers, Valuation Cases, Rate Cases, Committee on Unremunerative Rates, and prior to that Auditor of several Short Line Railroads in the Southwest, and for the Construction Companies which built those railroads.

I had a good deal of operating and construction experience on these Short Line Railroads.

3290 Prior to that I was in the Office of the Auditor of the Elgin, Joliet and Eastern and the Chicago Junction Railway Company.

I have given that to show that these things I have done were built upon a good deal of practical experience in my younger days.

Q. (By Mr. Pantaleoni.) Mr. Parker, your first conferences with Mr. Osborn and with me, occupied from De-

cember 9th to December 15th, as I recollect. You then made an examination?

A. That is correct. I was called into a conference by Mr. Osborn's counsel, Mr. Hodges and Mr. Pantaleoni, on about the sixth of December.

Q. 1937?

A. 1937.

Q. And you then spent three or four days examining the record in Washington?

A. That is correct. I was asked to make a preliminary inquiry as to whether the record before the Commission would disclose whether or not a satisfactory allocation of revenues and expenses had been made.

Q. What did you find?

Director Sweet: Did you discover when these proceedings began?

The Witness: Yes, sir. I made an examination
3291 of the whole record and found that the first hearing was held on August 5, 1935, and that there was a subsequent hearing in June, 1937, at which were introduced the Exhibits to which my attention was particularly directed, with the idea of discovering whether the record afforded a satisfactory allocation.

Director Sweet: Did you also discover when Mr. Osborn became interested in this railroad?

The Witness: When he first became interested in this railroad?

Director Sweet: Yes.

The Witness: No, sir, I did not.

Director Sweet: Was it before this proceeding began or since then?

Mr. Pantaleoni: You do not know when he acquired his holdings?

The Witness: I do not know when he acquired his holdings. When I first conferred with him, he explained that he was a holder and also a Director of the Milwaukee, and that he had become a Director, as I understand it, in August of last year, but when he acquired his holdings, I do not know.

Mr. Pantaleoni: May I state for the record that my recollection is he was elected a director in May, 1937,
3292 and the Commission's approval was given in June, 1937, and he attended the first Directors' Meeting I believe in September, 1937.

Director Sweet: Does the record show when he first acquired an interest in the Milwaukee Railroad?

Mr. Pantaleoni: The record does not show that. I can furnish that. I do not know it myself.

Director Sweet: Do you know whether or not he was interested before these Reorganization Proceedings began?

Mr. Pantaleoni: My impression is that he has held the bonds which he owns, he and members of his family, since 1928. My recollection is that all those bonds were bought when issued, and par was paid for them, but I cannot give that definitely. That is my understanding.

Director Sweet: Does counsel mind stating why Mr. Osborn has become active in this proceeding at this late date, rather than earlier in the proceeding?

Mr. Pantaleoni: Willingly.

The Plan proposed in 1935 was recognized by all persons interested as a stand-still agreement. No fundamental rights were being affected, but it was being put into a situation when, if conditions improved, he could not come back.

3293 Director Sweet: Then the reason for his participating now is because there is a different Plan, which he considers affects the rights definitely, from any plan heretofore proposed. Is that right?

Mr. Pantaleoni: I should add that it became evident, as time passed, subsequent to 1935, and became perfectly clear in June, 1937, that, as a business proposition, no plan was feasible, and no plan in all probability would result.

Therefore, neither Mr. Osborn nor any other persons interested felt justified in devoting much time to the study of relative rights or to the advisability of any particular plan. It was only after rumors started that a serious attempt to bring the company out of reorganization was to be made, that Mr. Osborn bestirred himself, and I think most other business men would have acted as he did, and would have been justified in so acting.

3294 Director Sweet: I suppose Mr. Osborn did not take seriously the original petition filed by the Milwaukee in this case and could not meet the obligations as they matured and desired to effect—

Mr. Panteleoni: Well, the plan of reorganization of 1935 was filed, as I remember it, simultaneously with that petition, is that not correct?

Director Sweet: Yes.

Mr. Panteleoni: I refer to my previous statement. As I understand their plan, it was a stand-by agreement and I think at that time even the committee which now pro-

poses a different plan thought it was a possibility. It became very obvious very soon that no plan could be prepared with conditions as chaotic as they then were or as I believe they have now become.

Q. (By Mr. Panteleoni.) Mr. Parker, when did you go to Chicago?

A. I went to Chicago on the 26th or 27th of December.

Q. Tell me about Chicago. What did you find in the way of a record down here with regard to the formula?

A. I found a record that was not adequate to determine whether or not a fair allocation of the revenues, expenses and income of the various mortgaged divisions had been made.

Q. In other words, from an examination of the
3295 various exhibits you could not tell how those exhibits were prepared?

A. Not with sufficient clarity to say whether or not they attained a fair result.

Q. Will you outline briefly what was the first impression you received of the general formula as it was presented after you had been there in Chicago for about two weeks? You made a report to Mr. Osborn?

A. That is correct.

Q. In that report, I believe you stated generally your first impressions?

A. Yes, sir.

Q. Suppose you just start with that report.

A. I made a report to Mr. Osborn and the following is my report regarding examination of the position of the 5 per cent bonds of 1975, in the pending Milwaukee reorganization which you requested me to make.

I spent several days in Washington examining the record of the proceeding before the Interstate Commerce Commission, more especially the exhibits and testimony purporting to show the net income available for interest on the properties of lines subject to the lien of the First and Refunding and the Five per cent of seventy-five mortgage. This was covered by Exhibits 139 to 146, inclusive.

3296 Inasmuch, however, as the exhibits in question were not supported by schedules showing in detail the various figures that were chosen, nor the calculations made, the various percentages and other statistical indices or factors employed, it was impossible for anyone to determine precisely what was done, nor to draw conclusions safely from it.

Following this, as you know, I spent two weeks at the

office of the debtor in Chicago, where I was received with every courtesy and accorded the most cordial assistance. The working papers supporting these exhibits are somewhat voluminous and contain a considerable body of figures derived from the accounts of the Company, and involved a large number of calculations, estimates, etc. Thus, it was necessary to spend the major portion of that time to finding out just what had been done, that is to say, to follow the data through step by step. I did devote some time to discussions looking to the possibility of the development of a formula upon which the officers of the Debtor and I could agree, and also some time to an examination of some actual movements of traffic between important points on the East and West lines, respectively.

However, in the time available I have had no opportunity to examine and analyze the operations of the
3297 Debtor, the relations of the accounts thereto, whether from the situation of the System, or as to the relation of the various mortgage divisions in respect thereto. Thus my criticisms and suggestions are confined largely to such matters as stand out from an examination of the particular formula proposed by the Debtor.

With this in mind, I give you such comments, as I am able, in the absence of opportunity to make the analysis of operations and the accounts, that would be desirable in connection with any effort to determine the proper method of allocation and apportionment.

The first thing that strikes me is that the present record, in particular Exhibits 139-145, inclusive, creates the impression that out of a total System income available for interest of $10,851,330, for the year 1936, the lines west of Mobridge, plus pieces of lines east of Mobridge which are under the First and Refunding, plus income from securities pledged under the First and Refunding Mortgage, fall short of earning anything available for interest by $536,404.

There is no comparable study of the revenue and expenses applicable to lines on which the General Mortgage is a first lien but if such a study were made and the same principles applied which are followed in Exhibits 139, 141, 143 and 145, the comparison would be approximately
3298 as follows:

A net income available for interest on the lines on which the First and Refunding is a first lien, including the C. T. H. & S. E. leasehold, aggregating about 3,795 miles of approximately $2,500,000, and for the lines subject to

the first lien of the Generals, a little over 6,100 miles, of about $4,608,000.

The figure of $2,500,000 for the First and Refunding properties, which, as I have said, is in reference to a little less than 4000 miles of line, derives from gross earnings of approximately $33,000,000, and the figure of $4,608,000 for the properties of the Generals, which as I have said consists of a little over six thousand miles of line, derives from gross revenues of approximately $77,000,000.

The figures given are taken directly from Debtor's exhibits, as they stand, except that I have had to make an estimate of the equipment rental which would be chargeable to the operations of the properties of the Generals, if the same basis be followed as that for exhibit 145. The details of the payments for car use, and detention of cars on the lines East were not immediately at hand, and I have had to make a rough estimate of this element. Aside from this item, however, the comparison I have stated takes
3299 Debtor's exhibits at their face without regard to my comments on certain features of Debtor's method and computations for Exhibit 145.

Expressed in another way, excluding the item of hire of equipment and rental of equipment as computed for the purposes of exhibits 139, 141, 143 and 145, the group of roads covered in those exhibits, which are the roads in which the Fives of seventy-five are interested, had income available for interest of $7,694,289 and the remainder of the System subject to the lien of the first mortgage $7,791,135.

In other words, that strikes this controversial question as to how equipment should be considered out of the statement and makes a comparison of that item.

Q. You are not passing on the question of who owns the equipment?

A. I am leaving aside the question of ownership and making that as an abstract cost comparison.

Q. In other words, you are comparing the rails?

A. Yes, sir, exactly. In other words, I approach the matter from the viewpoint originally the system equipment was not covered by equipment trusts and it was not shown to be clearly under the lien of the Generals and, in any event, such comparison as I have embodied in the report would be useful as an abstract cost study in showing
3300 the comparative position of the property, leaving aside the question of ownership of the equipment for the

moment. This would be the point of view in which the Commission would be interested from the point of view of the public interest.

I might add in that connection that the contribution of the First and Refunding properties to the net income available for interest on the lines of the Generals might be said to be made up as follows:

The contribution to the gross revenues made by the Milwaukee Northern is $1,738,704; by the Chicago, Terre Haute & Southeastern $2,626,938; by the Chicago, Milwaukee & Gary $317,737; by the First and Refunding lines, using that to refer to the lines west of Mobridge and the pieces, as has been referred to in the record, East, $6,249,099. The total of those four sums named is $10,928,478. Applying that to the Milwaukee operating ratio of 69.8 shows a net income of $3,300,400.

Q. Net income for whom?

A. That is the lines of the Generals. I ought to explain that for the C. T. H. & S. E. I had to make an estimate, because the exhibits did not show the proportion of Generals lines that derives from the amount which was
3301 shown as the earnings of the Terre Haute from commercial traffic. Then, in addition, the net income of the Generals includes the rental of the System equipment, a credit, as I understand it, on the part of the Terre Haute Railroad, of $297,943; debiting the Milwaukee & Northern $146,944, the Chicago, Milwaukee & Gary $20,500, and the First and Refunding $806,513, total for equipment of $676,014, or a total contribution to the net income of Generals of $3,976,414.

I should say that the figures I have just given have been derived from the revised figures put in in the present proceeding, 157 and 181.

The total net income for the Generals is shown to be $8,716,847. Deducting the above contribution of First and Refunding properties, $3,976,414, we have a net remaining of $4,740,433, out of which equipment trusts interest has to be paid of $1,155,159, leaving a balance of $3,585,274 to apply toward the interest of the Generals of $6,512,855.

This is merely to show the extent to which the income of the property of the Generals is derived from equipment which has been provided for System purposes and which, according to the theory of the exhibits, the Generals have been able to rent for use on lines subject to the lien

3302 of these mortgages, plus the income which is attributable to traffic which is interchanged between the lines of the Generals and the other mortgaged lines.

Of course, if the rental paid on equipment were lowered, say to the average return which the Generals makes on its total investment, say 1½ or 2 percent, this picture would be changed; that is, a portion of the income; and the Generals assignability to its general traffic would be increased and the net income of the other mortgaged lines would be also correspondingly increased.

Q. Have you some comments to make on the methods of apportionment which are shown in the exhibits?

A. I have the following comments on the composition of Exhibit 145, in respect to features wherein the First and Refunding Mortgage seems to have been adversely affected, unfairly, or which present the need of further examination.

1. Revenues apportioned to Western Lines were ascertained by expanding an actual determination for four months, by various percentage relationships and adjustments, to a figure designed to represent a full year. Instead of an estimate based on four months, the figures should be actually ascertained for the years 1936 and 1937.

3303 This work can be done at a cost of approximately five to six thousand dollars for the two years.

Q. Is that entirely your estimate or is that substantially in accord with the officers of the Debtor?

A. I made inquiry while I was in the office of the Comptroller in New York and he conferred with some members of his staff. This figure is based on information I gathered in that conference.

I think that figure is pretty largely confined, however, to the ascertainment of the actual revenues, probably a small amount in there contemplating that some additional expense would be incurred for the allocation or apportionment of the expense. It might go a little beyond this figure, but not much.

Q. How much time do you think it would take?

A. Well, it was stated that the actual ascertainment of the revenues for 1936 could be completed in about two months. My judgment would be that the allocation and apportionment of the expenses could be proceeded with in about the same period, inasmuch as that work would pretty largely fall on other branches of the office.

The revenues credited to the Western Lines would be in-

creased by approximately $300,000 by slight changes, which I think should be made, in the computations of the debtor, without departing from the basic plan upon which the exhibit was prepared.

3304 The method of arriving at revenues for Exhibit 145 is explained in Exhibit 146.

Briefly stated, as to interstate revenues, on traffic passing Mobridge, that is, moving both on Eastern and Western lines, the relation between actual revenues determined by a four month test, viz, January, April, July, and October, to the revenues which are used for reporting to the several States.

In short, according to the calculations which support the exhibit the interstate revenues for the lines West, as reported to the States for the four months in question were twenty-four percent greater than the actual interstate revenues ascertained for those months. Therefore the revenues as reported for the entire year to the States in which the lines West lie, were reduced in that ratio.

I should mention that certain adjustments were made in the figures of actual revenues before the calculation which arrived at twenty-four per cent was made.

First, the gross freight revenues, determined on an actual basis, were increased by percentages, intended to reflect the preferential divisions which, in theory, the lines west enjoy. These percentages are 2.29 per cent, on Eastbound, and 6.36 on Westbound business, respectively.

Secondly, there was deducted from the result thus
3305 obtained figures designed to reflect the amount of absorptions and corrections, that is, absorptions and corrections presumed to be applicable to the actual figures for the months in question which will not be recorded until later months. The amount thereof was determined by the percentage relationship of the absorption and corrections taken into account in the four months in question, to the gross freight revenues actually determined for those months, percentages of interstate and intrastate traffic being determined separately.

These percentages were 8.284 per cent on intrastate revenue and 2.253 per cent on interstate revenue. These percentages approximate the figures representative of the relation of absorptions and corrections to gross freight revenues for the whole year. For example, the percentages for the year are 8.159 per cent and 2.101 per cent on intrastate and interstate traffic respectively for the year.

Parenthetically, it may be noted, however, that even what appears to be trifling differences in the percentage relation of absorptions and corrections to the actual for the four months, as compared with the percentages for the year, affect the revenues credited to the Western Lines by several thousand dollars, in connection with the expan-
3306 sion process on a percentage basis from the four months actual to the figures for the year.

I gave considerable consideration to the question of whether this 24 per cent reduction in the State revenues was a fair basis to arrive at the actual revenues, because whether or not that percentage is correct has a pointed bearing on whether you have the facts or not.

It has been the practice on the Milwaukee for quite a number of years to "check" the comparative accuracy of the revenues reported to the States by reference to the actual revenues of certain "test" months. In other words, this is not the first time in which the Milwaukee Railroad has tried to find out what are the revenues which may fairly be said to be attributable to the operation of the lines west. But I think I am correct in stating, or at least, so far as the information was given to me is concerned, it has been the uniform practice to rely on some method such as was followed for the purposes of this proceeding, namely, by ascertainment for one month, two months or four months, then expanding that to represent a year's figures.

As I understand it, the revenues for apportionment to the States are determined by taking the System revenues, except for Minnesota, which is determined on an
3307 actual basis, and apportioning them on the basis of the net ton miles in each State for the System. The net ton miles are computed by the car accountant from conductors' wheel reports and embrace both company freight—that is, non-revenue freight—and revenue freight. The freight auditor makes an adjustment of those figures, deducting the non-revenue freight, which in his case, as I understand it, is compiled from the way-bills. Then the resulting figure is used to apportion the revenues to the States, and the question is to determine the extent to which the figure so arrived at differs from the actual revenues.

Incidentally I might call attention to the fact, of course, it is well known that there is a difference between the tonnages reflected by the conductors' wheel reports and the tonnages reflected by the way-bills, and that constant percentage of error appearing in there might have some bear-

ing on the result. I think not if a full year were taken, but the fluctuation from month to month might result in an invalidation of a figure expanded by a four months test period. Then again—I did not go into this very extensively—I think there is a variation between the traffic taken into account on the way-bill basis and the traffic returned on the conductors' wheel reports. This
3308 might account for a fluctuation or a variation, which might have a slight tendency to invalidate the figures that you get when you get all through with these various mathematics. However, these two things I have just mentioned, if they have any effect at all, I think they are very minor in character.

As I said, the practice on the Milwaukee for a great number of years has been to check the comparative accuracy of the revenues.

Generally speaking, the same months from year to year have been employed as test months. Thus, if these months were not representative, for some reason or other, the continued use of the same months would allow the facts with regard to that particular element of the matter to remain undisclosed.

These compilations show a percentage variation between the figures as reported to the States, briefly summarized as follows:

Revenues reported to States higher than actual revenues.

For 1923-1925	16 percent
1926 (based on Apr., July, Oct., Dec.)	12.44 "
1931 (Based on Apr., Oct.)	15.70 "
1932 (Based on October	20.14 "
1934 (Based on Jan., Apr., July, Oct.)	22.09 "
1935 (Based on Jan., Apr., July, Oct.)	22.12 "
1936 (Based on Jan., Apr., July, Oct.)	23.70 "

3309 It will be noted that there is considerable variation in the percentages shown, and that the trend in the spread between the "actual" revenue and the revenues reported to the States has been steadily increasing. The explanation that is offered for the steady increase in this spread is that the divisions on interline traffic have been changed from time to time which has caused the Lines West to suffer a diminution of its proportion, with the result that the revenues as reported to the States, get fur-

ther and further out of line, so to speak, with the "actual" revenues.

On that subject of divisions, I must confess to considerable lack of acquaintance with just what has transpired in reference to the subject of divisions in the West and Northwest. Of course, I know about the general division readjustments that have come before the Commission, but I am not familiar with the individual readjustments that may have been made as between individual lines or groups. I cannot believe there have been any such large changes in divisions as would have resulted in such a large change in this percentage. I cannot see how that explains that whole thing.

The variations in the percentages from year to year, it will be apparent, clearly indicate that the accuracy of 3310 the method is not sufficient demonstrated for purpose of settling this highly important point as to what are actual earnings of the Lines West.

Again, when we come to consider the percentages for the several months, separately, a considerable variation is noted. For example, the figures for the years 1935 and 1936, are as follows:

Revenues reported to States higher than actual revenues.

Year 1935	January	21.86	percent
	April	27.58	"
	July	27.08	"
	October	14.17	"
	Four months average	22.12	"
Year 1936	January	26.96	"
	April	25.95	"
	July	26.58	"
	October	16.75	"
	Four months average	23.70	"

Fluctuations, of course, are occasioned by differences in the volume of the kinds of traffic handled, in differences in the extent to which company material may or may not be carried in particular months, or the relation thereof one month to another, and perhaps other circumstances. Thus, the determination of the propriety of the use of these four

months for the purpose of expansion into a full year's
3311 figures must rest upon considerations affected by the relative volumes of different kinds of traffic (high or low rated, on the average, as will be perceived), and upon the extent to which the company material element for the months of the actual figures is fairly indicative of the situation for the entire year, and perhaps, as I have intimated, whether other elements such as any factor of error in the revenue and non-revenue ton mile figure, in any lack of correspondence between that item and the Freight Auditor's figures from which other data are determined, and, as to whether the corrections and absorptions percentage relationship for the "actual" months is indicative of the situation for an entire year. These considerations would entail some study to compare these various matters.

Even if these things were determined in a comprehensive way, the conclusion would still contain some element of speculation. Therefore, as I see it, the best way would be to compile the actual revenues for an entire year, and set at rest uncertainties as to its accuracy.

I would like to illustrate what those percentages mean. If you were to take the month of October, 1935, alone, you would say that the revenues reported to the States are
3312 14 per cent too high. The figure that has been used is 24 per cent, based on a four months test, but the percentages to meet the spread that exists between these various calculations would leave you in some doubt as to whether the figure is representative. That is important. This percentage is applied to a figure for the year, $15,000,000 of revenue, so that a 10 per cent difference, and as I have indicated the difference between October alone and the figure for the four months is 10 per cent, would mean a difference of a million and a half dollars in the revenues of the Western carriers or Western lines. I do not mean to say I think the revenues of the Western lines should be increased by a million and a half, but every point below which the 24 drops down, so to speak, means $150,000 additional revenue to the Western lines, and in a scheme where you are applying this percentage basis, it indicates what a tremendous effect the precision of that particular percentage chosen has on the result. As I have said, every one per cent by which the 24 per cent difference is reduced means about $150,000 additional revenue to the Western lines and 10 per cent would mean one and one half million dollars.

Q. You have some remarks to make on the mileage prorate, have you not?

A. No, I have not got to that yet.

3313 Q. Have you something on originated traffic?

A. No. I have not finished talking about this question, or this method of using percentages.

I mentioned the fact that the revenues credited to the Western lines would be increased by approximately $300,000 without any substantial change in the fundamental processes of the calculation. As I have explained, and as appears in the record, the actual revenues were calculated for four months. That figure was divided between intrastate and interstate and was further subdivided between that which moved 100 per cent west of Mobridge and that which passed over or through Mobridge, and further subdivided as to eastbound and westbound business.

To these figures, with reference to business passing over Mobridge, were applied percentages intended to reflect preferential divisions and from the figure so obtained there was a percentage applied to reduce it, intended to reflect the absorption and corrections taken into account in that month. Deducting the amount of the corrections and absorptions assumed to be proper for the month, you arrive at a net revenue as adjusted. This net revenue as adjusted in total was $5,352,921. Then there was set forth the net freight revenue as reported in the annual reports to the States for the four months of 1936.

3314 Q. A comparable four months?

A. The same four months. This was subdivided by States and by intrastate and interstate. The total reported to the States was for lines west, intrastate, $1,078,413; interstate, $5,301,117, or a total of $6,379,530.

Incidentally I call attention to the fact that in arriving at these figures it was necessary to make a split of the revenues reported to North Dakota and South Dakota as between the lines west of Mobridge and east of Mobridge, respectively, because the lines west and the lines east respectively lie partly in those States.

In making this division, resort is had to the net ton miles for the States of North Dakota and South Dakota east of Mobridge and west of Mobridge, respectively. The total revenues reported to the States for North Dakota and South Dakota aggregate $2,922,000, out of a total of $6,379,000; so that it is an important part of the aggregate.

This whole uncertainty as to the percentage by which the interstate revenues as reported to the States were to be reduced comes about through the fact that the revenues are credited to the States or reported to the States, rather on the basis of net ton miles of the System; yet we have
3315 in the calculation that is designed to resolve all doubts about this thing $2,922,000 which is still subdivided between the lines east and the lines west of Mobridge on the basis of net ton miles.

3316 Now, I go back to this adjusted figure of net revenue which, as I have said, aggregates $5,352,421, and which is made up of $1,049,835 of intrastate revenue and $4,302,586 of interstate revenue. In the calculations which arrived at the 24 per cent there was deducted from the net revenue as adjusted, $5,352,421, the sum of $1,078,413 as the intrastate revenue reported in the annual reports to the state, which is the gross figure as I understand it, and not the net figure which went to make up the $5,352,421. In other words, in the process they have deducted a gross figure from a net figure and the resulting determination, namely, $4,274,008 is the divisor which they used in connection with the interstate figure of $5,301,107 which they use to arrive at the figure of 1.24, which gives the 24 per cent.

Now, I think that in that calculation there should either be used the intrastate revenue adjusted to bring it down to a net figure by the percentages, in which event you arrive at a percentage of, in place of 24, of 21.5, and 21.5 per cent gives you roughly $260,000 difference.

Q. Of increase in favor of the lines west?

A. Increase in favor of the lines west.

Now, if instead of using the figure of $1,078,413
3317 which is the gross figure as reported to the states, you use the net figure included in the calculation which arrives at the net revenue as adjusted of $5,352,421, it would put the percentage somewhere midway between the 1.215 and the 1.24 that I have spoken of.

I have not worked that out because my thought is that you get into such an area of speculation about these figures that it isn't just worth while to run out all the different calculations.

Now, I would like to say this, that I am not offering this as meticulous fault-finding with someone's statistics or study, or with someone's calculations. I would say

this, that as a matter of statistical expression of things that are susceptible of expression by statistics, and the manner in which the job is done, I think it is fine, splendid; probably if I were given the same data to work with and the tools that they have I would have followed pretty much the same basis as has been followed, and I hope I would have done the job as accurately as it has been done by the Milwaukee officers and staff, but to my mind what this leads to is the realm of speculation you get into as to whether your results mean anything when you superimpose per cent and average upon average.

That is, I do not put this forward as indicating
3318 beyond all peradventure of a doubt that a million dollars should be added to the west lines. I think it is probable that a very large sum would be added if an accurate ascertainment was made, but I do put it forward as indicating that certainly these figures do not show in any satisfactory way the revenues of the western lines in such a way that you can rely on them.

Examiner Jameson: Well, isn't it an allocation between the lines east and the lines west; in any event could you say that what you arrive at for the lines west would be a contribution which the system would lose if those lines were eliminated.

The Witness: No, I wasn't thinking of that, Mr. Examiner, if I understand your question. I wasn't thinking of that. I wasn't even thinking of it as an allocation.

Examiner Jameson: You call it a contribution of the western lines, though, didn't you?

The Witness: No, not in connection with this particular thing. In my earnier statement where I was discussing the net increases shown I was speaking there of the contribution of the lines west to the income and in connection with that I had in mind the revenues on traffic that is interchanged with the lines west but actually not moved on the lines east.

3319 There I spoke of the contribution but I do not consider that the revenue of the lines west. That is very definitely the revenue of the lines east and I merely mention it as indicating the extent to which there is an inter-dependence there.

But here I am speaking now of the actual revenues of the lines west and dealing with that I say that this figure which is given as the allocated figure of revenues for the

lines west is not dependably arrived at and to the extent that it is arrived at by this process the indications are that he is very much too low.

Now, to go on with my report.

Director Sweet: You are reading now from the report that you made?

The Witness: I am reading from a report to Mr. Osborn. What I have said there was to explain more in detail than was contained in my report. I am reading now from the report:

But this gives no consideration to whether the basic method is fundamentally sound, whether the four months are representative, and other matters of that sort, all of which can be resolved only by making an actual ascertainment, under proper supervision for a full year.

3320 In addition to the mileage prorate of revenues there should be preferential divisions to each line in respect to the traffic which it originates, or in respect to differences in conditions which are customarily taken with consideration in the fixing of divisions, differences in the density of traffic, in the general rate levels, and other similar matters.

The formula employed for Exhibit No. 145, as I have said, allows preferential divisions to the Western lines of 2.29 per cent of actual gross freight revenue (mileage prorate) on eastbound traffic, and 6.36 per cent on westbound traffic.

Tentatively, I think a figure which would allow to the originating line 10 per cent of the through rate, before prorating on a mileage basis, would be proper and that support therefore, can be found in the practices of carriers, the policy and language of the Interstate Commerce Act, and in the decisions of the Commission dealing with divisions between carriers.

This would add an additional two hundred or two hundred and fifty thousand dollars to the revenues of the Western lines.

Q. Is that in lieu of the 2.29 per cent?

A. Yes, sir. I had in mind in lieu of that 2.29 per cent.

3321 Exhibit No. 145 credits western lines approximately $600,000 for handling company materials (this is a net figure between amount credited to lines west for handling company material for other mortgaged divisions,

and the amount charged lines west on company material handled for it by other mortgaged divisions).

The figure in question is arrived at by the use of an out-of-pocket cost figure of about four mills per ton per mile. I think a somewhat larger portion of the respective mortgage division's operating expenses would be appropriate, perhaps, 5 to 5.5 mills per ton per mile.

In other words, in charging pro and con among the several mortgage divisions for handling company material quite as good a case can be made out for charging a portion of total expenses of the respective mortgage lines as taking arbitrary or out of pocket cost as the basis.

The exhibit computes the revenues and expenses of certain so-called "bridge" lines, that is, segments of the main lines of the eastern portion of the system (enumerated below), by allowing these lines, revenues computed by multiplying the revenue ton miles handled over these "bridge" lines by the system average revenue per 3322 ton mile.

Operating expenses are computed by various apportionments of system and operating division expenses. In the computation in question there is included $363,800 erroneously, as I think, based on the ratio of the expenses of the Chicago, Milwaukee & Twin City Terminal divisions to the total operating revenues for the System with which the "bridge" lines have no immediate physical connection.

The method of apportionment for Exhibit No. 145 makes no allowance for the strategic importance of these "bridge" lines.

For example, the following shows in summary fashion, the termini and location of these lines with reference to the lines of which they are a part.

"Bridge" Lines Termini	Length (miles)	Location with reference to System Lines
Bowdle, S. D. to Mobridge, S. D.	39.86	Portion of main line Minneapolis, Minn. to Seattle, Wash.
Steward Jct., Ill. to Seatonville, Ill.	36.60	Portion of branch line.
Ashdale, Ill. to Ebner, Ill.	15.12	Freight cut-off, Chicago, Ill., to Kansas City, main line.

3323 Libertyville, Ill. to Janesville, Wis.	59.89	Portion of line Rondout, Ill. to Madison, Wisconsin.
Muscatine, Ia. to Rutledge, Ia.	76.30	Portion of main line Chicago, Ill. to Kansas City, Mo.

As will be noted, these are connecting links of great importance, the strategic value of which cannot be ignored.

Perhaps the questions affecting these lines as related to the lien of the Fives of 75 could best be dealt with by considering them on a rental basis, which would add, I believe, on a fair rental basis, substantially to the income available for interest from the point of view of the Fives of 75 as compared with the amount included in Exhibit No. 145.

Exhibit No. 145 makes no allowance for the value of the securities pledged under the first and refunding mortgage, viz.

	Capital Stock (Shares)	Bonds
Chicago, Milwaukee & Gary Ry. Co.	9993	$2,700,000
Chgo. Terre Haute & S. E. Ry. Co.	40457.2	1,515,000
Davenport, R. I. & N. W. Ry.	14997	
Des Moines Union Ry. Co.	1996	
Indiana Harbor Belt Ry. Co.	15198	
Kansas City Terminal Ry. Co.	1828	
3324 Minneapolis Eastern Ry. Co.	620	75,000
Minnesota Transfer Ry. Co.	70	
St. Paul Union Depot Co.	1530	

I do not think that is an exhaustive or complete statement of the securities pledged, but I was listing those that were connected with primarily the railway properties which I thought were important.

Only the interest actually paid on the above securities is credited to lines on which the first and refundings are a first lien in Exhibit No. 145, for the year 1936, being $402,031.

Certain of the railways shown in the list above provide the terminals at important points, by means of which the Milwaukee gains entrance and operates its freight and passenger trains thereto and therefrom, e. g., Kansas City, the Twin Cities, Des Moines, etc. While those terminals

are operated under agreements between the Milwaukee and other proprietary companies which antedate the date of creation of the first and refunding mortgage, and while such operating agreements contain restrictions as to the disposition which may be made of the capital stocks, which secure to the several proprietary companies the assurance of continuance of the right and privileges of the use by virtue of the agreements, nevertheless it seems to
3325 me that there is some value to the equity of the first and refunding mortgage in these securities.

It is a somewhat difficult thing to make a calculation as to this item, but some allowance should be made proportioned to the volume of business of the Milwaukee Railroad at these respective terminals.

Perhaps an additional three to five hundred thousand dollars would be proper on this account.

That is a very rough estimate on my part, based on just a general and hurried view of the volume of business which is handled through some of those terminals.

Exhibit No. 145 includes, with reference to the C. T. H. & S. E. leasehold which is pledged under first and refunding and the 5's of '75 mortgages only the interest on the bonds actually paid in 1936, amounting to $75,750.

Exhibit No. 139, which is a statement of revenues, expenses and net income of the Chicago, Terre Haute & Southeastern Railway for the year 1936, shows a net income to the Milwaukee of $1,825,266. This figure makes allowance for the handling of a large amount of the Company coal, at tariff rates, and the figure mentioned is after deduction of rental paid by the Milwaukee, being interest on funded debt in the hands of the public but
3326 excluding $1,515,000 bonds owned by the Milwaukee and pledged.

It seems to me that the figure of $1,825,266 should be considered, or something approximating it, as the value of the leasehold to the 5's of '75 instead of the $75,750 of interest on bonds credited to it.

I might say that the defect that I thought existed in the record in that behalf is cured in part by the introduction of Exhibit 157, and also Exhibit 181 which combined the showing of the first and refunding mortgage properties.

But Exhibit 157 is corrected from the figure of $1,825,266 net to a figure of $875,327 due to the changes in the handling of equipment and in the handling of company material.

Q. It was testified to by Mr. Walker that no credit was

given in the Terre Haute computation to the fact that the system was in default to the extent of about seven million dollars of equipment. Have you any comment with reference to that?

A. Well, including the effect thereof that the rates used in the exhibits in dealing with the subject of equipment rental, the combined figure for the first and refunding properties shows an income for those properties of $129,-404.

Q. Will you give that a little more in detail, start-
3327 ing with the Terre Haute? How much credit have you got to offset that seven million dollars of default?

A. Well, I took that $7,000,000 worth of equipment in at 5 per cent, which is the rate which is used throughout these exhibits in dealing with equipment.

Q. That added about $3,500?

A. That added about $350,000.

And just the algebraic sum of the net increases and losses shown on Exhibit 181, with the introduction of $350,000 shows a net income for those properties of $129,-404.

Q. Have you any comments to make with regard to that 5 per cent equipment charge?

A. Well, I have already intimated that—

Q. No, I assume now that it is proper and consistent to charge something.

A. I am not so sure about that.

Q. Well, I am asking you to assume that. I will have to share all of your doubts.

A. I am not so sure about that

Q. Well, taking it one way—

A. But certainly I think the rate should not be higher than the average rate which the property as a whole makes on its investment and I have intimated that that was my feeling when I made the summarization of the show-
3328 ing of these roads when shown on a comparable basis, and if it was figured at 1½ or 2 per cent the income from the generals would probably be more and the income from the other mortgaged properties would be less, and I think that is—yes, the rate should not be higher than that, but as I say, I think there is considerable doubt whether on the whole case any charge for system equipment should be made.

Q. How about the expenses?

A. However, I guess most everybody is against me on that.

Q. How about the proportion of expenses to the western lines, do you care to comment on that?

3329 A. The apportionment of expenses to the Western lines should be further scrutinized. In large part expenses are ascertained for the Western lines from operating division expenses, as regularly kept from month to month, the lines West consisting of three operating divisions, viz. Trans. Missouri, Rocky Mountain and Coast.

Expenses are assigned or apportioned in accordance with instructions contained in a circular issued by the Auditor of Expenditure. While the results may be wholly satisfactory for the purpose of observation of the performance from month to month of current operating performances, my judgment tentatively is that the result is to throw a disproportionate amount of expenses on the Western Lines.

The following shows the percentage of expenses by general accounts to revenues for the lines West and for the Milwaukee System, for the year 1936,—according to the Annual Report for the System and Exhibit 145 for lines West.

3330

	System		Lines West	
	Amount	Per Cent of Oper. Revenues	Amount	Per Cent of Oper. Revenues
Operating Revenues	$109,142,086		$18,417,629	
Operating Expenses				
Main. of Way and Structures	18,561,823	17.0	4,446,537	24.1
Maint. of Equipment	19,652,864	18.0	3,678,711	19.9
Traffic	2,559,788	2.4	386,449	2.4
Transport.	40,501,964	37.1	7,056,102	38.2
General Exp.	3,500,799	3.2	615,785	3.3
Total Oper. Exp. (1)	85,244,354	78.1	16,346,976	88.5
Total Oper. Exp. (2)	85,840,700	78.6	15,750,630	85.5

(1) Excluding debit and credit for company material for other mortgage lines.

(2) Including debits and credits for company material for other mortgage lines.

And this figure of $85,840,700 is based on the earlier Exhibits which included the Terre Haute at tariff rates.

Obviously, the ratio of expenses, particularly in
3331 relation to Maintenance of Way Expenses, is much higher than on the remainder of the System.

Q. (By Mr. Pantaleoni.) That is, much higher on the Western Lines.

A. This is due, no doubt, in part to the relatively lighter traffic and revenues on the lines West. It may be due, in part, however, to the possibility that the method of apportionment may shift a disproportionate share of the system expenses on to the lines West.

An illustration on one point will indicate what may be possible in that regard. The account, Superintendence under Maintenance of Way and Structures is pro-rated between operating divisions on the basis of total track miles including tracks operated under trackage rights.

Speaking with reference to figures which do not include certain accounting adjustments (the details of which I do not have by operating divisions but which cannot, I think materially affect the conclusions), it appears that comparing 1936 with 1934 total maintenance of way expenses other than Superintendence for the lines East increased from $8,517,231 to $13,279,329 or 55.9 per cent.

Superintendence for the lines East, as apportioned
3332 increased from $737,320 to $919,965 or 24.7 per cent.

On the other hand for the Lines West, Maintenance increased comparing 1936 and 1934 from $3,181,870 to $4,467,742 or 30 per cent, whereas superintendence increased, comparing the same periods from $247,617 to $314,929, or 27 per cent.

In other words with 55 per cent more maintenance, measured in money, in 1936 than in 1934, for the Eastern Lines, superintendence was, as apportioned for the Eastern lines only 24.7 per cent greater, whereas for the Western Lines, 30 per cent more maintenance, measured by expenditures, entailed 27 per cent more superintendence.

Another item which deserved attention is the matter of freight train car repairs. Freight train car repairs are charged to the Western Lines on the basis of the system costs per car mile.

In my opinion the unite cost should be somewhat less on lines West than on lines East. The average length of haul of Western lines is considerably greater than the

average on Eastern Lines, which would cause more frequent terminal handling of cars on lines East.

For example, in the so-called Oklahoma formula
3333 which was developed in 1916 and introduced by the railroads in a number of State rate cases, the following statement was made in reference to the bases that were used in developing freight car repairs.

"Apportionment of Expenses between 'Line' and 'Terminal' by primary accounts:

Maintenance of Equipment:

34 Freight Train Car Repairs," I am quoting now from the report of the report of the railroad people who developed the formula.

"The amount of repairs to Freight Train cars attributable to 'Line' or Terminal service (except accident repairs), is wholly a matter of opinion which must be determined by experts, who, because of their experience are properly qualified to make such estimates.

"It, therefore, was submitted by letter ballot by the Chairman of the General Managers' Association to its members as to the proportions properly chargeable to 'Line' and 'Terminal' and the average of such expressed opinions has been used in the assignment under these two classes.

"The submission of the question was accompanied by a full explanation of exactly what under this formula constitutes 'Line' and 'Terminal' service, respectively.
3334 The proportions ~~thus arrived~~ at were 36.03 'Line' and 63.97 'Terminal' ".

That formula was also introduced in ICC Ex Parte 91, where however a figure 65.35 instead of 63.97 as the terminal proportion of freight car repairs was used.

Again, in study No. 3681 by the Bureau of Statistics of the Interstate Commerce Commission which was a study of average costs by B. T. Elmore, the Senior Statistical Analyst, the Division of Car repairs was made on per car day basis.

The freight traffic report of the Federal Coordinator of Transportation contains a summary showing the average days per car in transit, on a selected day, December 13, 1933; the total for all cars, car load, is 6 days in transit.

Of this total only .95 of day is in road movement, the remainder being in yard and terminal service, and is indicative of the great length of time cars are in terminals

than on the road and because of the difference in the length of haul comparing the Eastern and Western lines of the Milwaukee Railroad, it is apparent that the apportionment of car repairs on the basis of the System average cost per car mile results in over charges to the Western Lines
3335 for this account.

My own estimate is that it is, perhaps, thirty to forty per cent too high, which would adversely affect the West Lines as shown in Exhibit 145 by, perhaps two to three hundred thousand dollars.

In connection with my suggestions that the only way that the revenues of the Western Lines can be satisfactorily determined, (I am reading from my report to Mr. Osborn), is by an ascertainment for the years 1936 and 1937.

I make this comment or suggestion in the light of the fact that the present earnings position of the Debtor is wholly unpropitious for the making of any reorganization plan that is not likely to do injury to some of the security holders, and the present outlook is so fraught with uncertainties that I believe the Commission cannot help but withhold making a plan until such time as the situation is somewhat clarified. And the necessity for withholding the making of a plan incident to giving the situation a chance to clear up, will afford the time and permit the opportunity to resolve some of these questions more authoritatively.

Among other things, my own thought is that maintenance of way and structures should be considered
3336 with reference to a norm or standard rather than the expenses of a single year.

For example, I have already referred to a comparison of the Maintenance of Way Expenses for the Lines East and West for the years 1934 and 1936.

Maintenance of Way and Structures expenses for the System were:

1934—$12,851,519.
1935— 17,023,868.
1936— 18,561,825.

I am not able to say what part of the increases in the two later years over 1934 are due to increases in wages and prices, but on their face they would seem to indicate that they represent making up some deferred maintenance which accrued in earlier years.

On the other hand, they may represent substantially the maintenance which is expected to be encountered for the future.

These questions should be resolved before the allocation of revenues and expenses is thought to be conclusive for the purposes for which it is put forth.

There may be other matters, which, for the reasons I have explained, I have not had the time to go into.

Mr. Pantaleoni: Now, have you any additional comment?

3337 The Witness: Well, there are a number of things that I have—well, practically no. I did notice in passing, one or two things that are insignificant, matters that might be checked up more carefully.

For example, I noted on the allocation of the Social Security and Railroad Retirement taxes, that they are apportioned on an operating expense basis. Probably a payroll basis would be nearer to the fact or rights of the Lines West and the Lines East.

Just what the result would be, I do not know. And there are a number of things of that sort to be checked up more carefully, if the Commission is to have authoritative data on which to base its decision.

Mr. Pantaleoni: That is all on direct, Mr. Director.

Director Sweet: Any cross-examination?

Cross-Examination.

Q. (By Mr. Burgess.) When you went out to Chicago, Mr. Parker, and went to the offices of the Debtor, what officers did you talk to regarding this matter of the allocations that had been made?

A. Specifically with regard to the allocations, I talked to the Comptroller and to some of his staff.

Q. Who is that?

A. May I answer your question?

3338 Q. Certainly, go ahead.

A. When I first went out there I talked with Mr. Scandrett, the President. My talk with him was rather insignificant, he turned me over to Mr. Harstadt, and my first talk with him was rather insignificant, and he turned me over to Mr. Walter Wilson the Comptroller, and my contacts thereafter were substantially with Mr. Wilson and with the members of his staff.

Q. And who were some of the members of the staff that worked with you in supplying this data; did you work with Mr. Oliphant?

A. Well, Mr. Oliphant.

Q. Mr. Severs?

A. Mr. Severs, Mr. Kiley and Mr. Peterson.

Q. And did they—

A. They were very cooperative and very helpful, and I would like to explain this at the outset of the examination. Mr. Scandrett hoped that I would go into everything fully with him before I left, and to every extent possible I did that and they cleared me up on quite a number of points on which I was at first in doubt, and some of these matters which I have now brought forward either did not occur to me or I had not worked them out then.

Q. Some of these men had worked on the studies
3339 that were incorporated in 139, and 145, had they?

A. That is correct, yes, sir.

Q. And you discussed with them the bases that they had used?

A. Quite extensively, considering the limited time.

Q. Now, did you find that any of those men as you discussed the matter with them, indicated that they had undertaken to establish any particular proposition when they made those studies, or did you find that they had approached it with an effort to do the best they could in developing an accurate result within the limitations of the time at their disposal; in other words, did any of them show any personal attitude?

A. They were not trying to establish a particular proposition, they were trying to produce accurate results.

Q. But I mean, did they approach it in any way indicating that they wanted to establish a particular proposition?

A. I want to answer that question fairly, Mr. Burgess. The answer to it shortly is no. Very definitely, no, they did not, but I do think that there may be, subconsciously, a general inclination on the part of Milwaukee Officers as a whole to have a little slant that the Western Lines are
3340 not quite as tightly a part of the System as the Eastern Lines. Now that, as I say, that is just a general impression, it may not amount to anything, but from the point of view is yes, they tried to reach a fair conclusion.

Q. When was the Puget Sound Extension opened, if you recall, just roughly?

A. I think it was in 1908, 1910, 1912, around in there.

Q. And prior to that time the Milwaukee had been a very profitable company, had it not?

A. That is my impression.

Now, I have not studied the operations of the Milwaukee to any great extent.

Q. I see.

A. That is recollection.

Mr. Burgess: That is all.

The Witness: And that is the general impression.

Q. (By Mr. Burgess.) Oh, just one more thing, those Western Lines do operate in a mountainous territory?

A. Oh, yes, I have been over the Milwaukee, not for this case, but years ago.

Q. And the maintenance expenses must be inevitably reflected by the character of the country over which the railroad operates?

A. Oh, unquestionably.

3341 Q. And the train expense, that is, the transportation expense is also affected by the character of the country traversed, is it not?

A. Yes, but I would not be able to say just what the effect of it was here, because I have not studied the operations.

Mr. Burgess: I understand. That is all.

Director Sweet: Any other questions?

(No response.)

Director Sweet: The Witness may be excused.

(Witness excused.)

Mr. Fitzgibbon: Mr. Director, on behalf of the Trustees of the Fifty-Year Mortgage, in the light of the record here made, and in view of the conferences which I as counsel for the Trustee have had with Mr. Osborn, as to having a more adequate record made upon which the Fifty-Year Bondholders can decide what action to take with regard to this Plan in these Reorganization proceedings, I would like to say that this question seems to me to divide itself into two very important questions; one, the matter of the corporate structure, and secondly the matter of allocation of the new securities.

It is my intention, if postponement is here allowed by the Commission, to recommend to the Trustees of the 3342 Fifty-Year Mortgage that they try to get their Bondholders together and see what further steps the bond-

holders desire to take in connection with this matter, whether they desire to ask the Debtor, in accordance with the statement set out in its Modifications, to make a further study of this matter, that would be one thing that the bondholders might rely upon.

The second step might be to have the Railway Trustees give further study to this matter. The third might be for them to petition the Court to have the Commission make a further study, and the fourth may be that the bondholders would decide to do that entirely themselves.

Now, it is in the light of these thoughts that I have just spoken of that I should like to renew the motion in regard to the postponement of the hearing.

Director Sweet: Any other witnesses to be presented at this time?

(No response.)

Any parties here who desire to testify regarding the pending plans?

(No response.)

Apparently none.

3343 Mr. Swaine: Mr. Director, the Debtor joins in the motion that has been made on behalf of Mr. Osborn and on behalf of the several mortgage trustees for a further postponement, and request that that postponement be to a period not earlier than July 1, 1938.

We ask for an adjournment, first, to permit a study of the effect of the decision of this Commission on the matter of rates, now pending, upon the revenues of the System, in order to determine whether the capital structure proposed in this plan will afford a sound capital structure which will meet the tests of Section 77.

It is perfectly patent that the capital structure proposed in both the Plans now before this Commission cannot meet the tests which are in the law, based upon the present conditions. It must be patent that had either of the Plans now before the Commission been in effect during the last few years, or were they in effect now, this company could not live and could not finance itself.

It therefore is imperative in determining whether either of the plans now before the Court can meet the tests of Section 77, that there be a study of the effect of the rate increase.

Neither the Debtor nor the security holders have
3344 any basis for speculation upon what the position of

this line may be, however much basis the Bureau of Finance may have to indulge in such a speculation.

Secondly we ask for that adjournment in order to enable the classes of security holders, as to whom only small minorities are represented by the institutional investors committee, to study the propriety of taking away the lien of the Fifty-year Five's and giving it to the General Mortgage Bonds in exchange for a partial Pari Passu lien, second lien on the general mortgage line.

That problem was never presented to the Debtor or to any security holders of this property until January 10th of this year.

That involves so fundamental a question as to make it imperative, if there is to be any facts in the record upon which a plan of reorganization involving such a proposition can have any hope of being sustained by the Court, I say that is so fundamental a problem that there must be further evidence in the record than there is today.

Now, it is not already in the record, but I would be glad to be sworn, if my statement to this effect cannot be admitted, but it is a fact that Mr. Sparrow, the man who
3345 is responsible for the only kind of a segregation study that was made, even he has stated to the board, and advised the Board of Directors himself, that in his opinion that study was inadequate to determine the propriety of the proposal for the disturbance of the lien.

Now, I was prepared to call Mr. Colpitts last night, and offer his testimony. Mr. Colpitts is a man of experience, his firm has made many studies in reorganizations to determine the proper solution of exactly this kind of a problem.

Had Mr. Colpitts been able to stay over until this morning, or had he been permitted to testify last night, he would have said that in his opinion there are no facts before the Board of Directors today upon which an expert in these problems can frame a conclusion as to whether it is proper to disturb the lien of the Fifty-year Five's as this plan proposes.

3346 Now, none of us is saying that we think it is improper. What we are saying is that we are agnostic, we don't know, and there is no record upon which the Bureau of Finance or the Interstate Commerce Commission or anybody else can found an opinion on that question.

We ask for that adjournment in the third place to enable

the Debtor and the institutional investors' committee to get together and try to iron out the character of security proposed with respect to the first mortgage and the general mortgage and the funds for which they provide, which will be workable.

It is no fault of Mr. Walker's and no fault of Mr. Burgess, and my question was not intended to imply any criticism, but it is the fact that they have been so engrossed in their problems that they did not have time to sit down and develop with us the questions, notwithstanding that we were ready to and asked them to, they did not have the time to sit down with us and discuss the provisions of their plan in regard to the mortgages and in regard to the funds.

Nor did we have opportunity to sit down with them and get the benefit of their advice in respect of our own suggestions with respect to those securities.

The provisions with respect to corporate securities
3347 are not something that can be tossed off lightly or dragged down out of the blue, because they involve important problems, they are not being built for today or for tomorrow. They are being built for a long period of time.

The 1928 reorganization of this property has been bitterly criticized by public authorities. Some of the members of this Commission criticized it when it was passed. I say to you that the 1928 reorganization was carried out with a far more thorough study of every problem involved than exists today in respect of this reorganization.

The reasons that are apparent, not only with respect to the total capitalization, with respect to its distribution, and also with respect to the provisions of the mortgages, are so much greater than they were in 1928 that it is perfect folly for anyone to move ahead without further thought on all three of the problems.

It is for those three purposes that the Debtor asks that this hearing be adjourned at least until July 1, 1938. In the meantime the Debtor desires formally to propose that the institutional investors' plan be modified, at least to the extent provided in Exhibit 189.

Illustrating also the fact that that was prepared un-
der pressure and subject to human error, I would like
3348 to say that on page 13 under G, general creditors, there is an obvious mistake. That provision simply listed over the institutional investors provision that un-

secured creditors should receive one share of stock for each $500 of claims. In view of the proposal of these modifications, with that treatment of the stock, that would be an obvious violation of the Boyd Case, and the Debtor wishes to change the figure $500 to the figure $200, for that purpose.

Now, we admit that we worked under pressure; we are sure, and we have assumed that the representatives of the institutional investors worked under pressure, and we would like to have an opportunity to sit down with them and try to be reasonable, and we are sure they will be reasonable and we think we can get together on a plan as to which the probability is that the only difference between us will be as to the allocation of securities, and if we may sit down with them I think that a great deal of the objection will be obviated.

Mr. Orschel: Speaking in behalf of the preferred stockholders committee, I would like to join in motion which has been made. I cannot improve upon their very adequate statement as made by Mr. Swaine and by Mr. Pantaleoni: I do think, however, and the committee thinks,
3349 of course, that we should have further time, the road is obviously being well operated and no hardship can come from giving this additional time during which to consider the matter, and I think there should be given additional time for very, very thorough consideration.

The preferred stockholders obviously in the length of time available have not been able to develop even the surface of things, which might be available on a further study.

Therefore, I, too, respectfully request that this matter be continued.

Mr. Hill: On behalf of the National City Bank of New York and the Trustee of the adjustment mortgage, I wish to join in the motion made on behalf of the Debtor and Mr. Osborn.

Director Sweet: Has anybody else anything to say?

(No response.)

Director Sweet: As I understand it, the Commission is very defintely of the view that this statute, Section 77 of the Bankruptcy Act is not a moratorium statute. The Supreme Court has told the Commission and the courts of the country that it is incumbent upon them to proceed expeditiously in disposing of these reorganization proceedings.

If is for the Commission in each of these cases

3350 to decide whether plans that have been proposed, or any other plans, are equitable and practicable and workable, and also to decide whether or not the plans, any plan, can be adopted under the circumstances.

Those are matters for final decision after the conclusion of hearings on plans that have been presented. It seems to us that it is necessary to proceed expeditiously to conclude hearings on plans that have been presented.

With that thought in mind, this hearing will be adjourned until the 21st of March, 1938 with a view to concluding hearings on pending plans at that time.

(Whereupon, at 12:25 o'clock, p.m., an adjournment was taken to Monday, March 21, 1938, at 10 o'clock a. m.)

3735 ORDER.

At a Session of the Interstate Commerce Commission, Division 4, held at its office in Washington, D. C., on the 12th day of March, A. D. 1938.

* * (Caption—10882) * *

Upon further consideration of the record in the above-entitled proceeding and of the petition filed March 7, 1938, by the Guaranty Trust Company of New York and Merrel P. Callaway, trustees under the Chicago, Milwaukee, St. Paul and Pacific Railroad Company fifty-year mortgage, securing the five percent gold bonds due February 1, 1975, and interveners herein, requesting that the further hearing assigned before this Commission on March 21, 1938, be adjourned to May 23, 1938;

It is ordered, That said petition be, and it is hereby, denied.

By the Commission, division 4.

W. P. Bartel,
Secretary.

(Seal)

5235 BEFORE THE INTERSTATE COMMERCE COMMISSION.

(Caption—10882)

Hearing Room C,
I. C. C. Building,
Washington, D. C.,
March 21, 1938.

The above-entitled matter came on for further hearing, pursuant to the adjournment, at 10 o'clock a. m.

Before:

Commissioner Claude R. Porter, and
Director Oliver E. Sweet.

Appearances:

The same as heretofore noted.

Additional Appearances:

William J. Kane and Daniel Willard, Jr., Transportation Building, Washington, D. C., appearing for The Railroad Credit Corporation.

R. L. Gilpatric, 15 Broad Street, New York, N. Y., appearing for the Debtor.

Donald J. Sherbondy, Room 336 United States
5236 Treasury Building, Washington, D. C., appearing for the Treasury Department.

M'Ready Sykes, 45 Wall Street, New York, N. Y., appearing for United States Trust Company of New York as Trustee under the general mortgage.

William V. Hodges and Guido Pantaleoni, Jr., 20 Pine Street, New York, N. Y., appearing for William Church Osborn, Intervener.

John E. Benton and Clyde S. Bailey, 7413 New Post Office Building, Washington, D. C., appearing for Illinois Commerce Commission.

A. Marvin Braverman, Washington, D. C., appearing for Reconstruction Finance Corporation.

5239 PROCEEDINGS.

Director Sweet: The hearing on plans of the reorganization of the Chicago, Milwaukee, St. Paul & Pacific Railway Company is resumed this morning pursuant to an adjournment taken at the last hearing.

Are there new appearances; that is, appearances by any who have not heretofore appeared? Apparently none.

Mr. Pantaleoni: May I simply ask there, Mr. Director: There has been a valuation made by a committee for the 5's of '75, but I think up until that committee has been approved by the Commission, they have no standing to appear.

Director Sweet: Which committee are you referring to?

Mr. Pantaleoni: The committee for the 5's of '75.

Director Sweet: No, the committee could hardly intervene until it has been authorized.

Mr. Pantaleoni: Right on that same subject, might I ask if it is customary to serve all parties of this proceeding with copies of that? We have not done so.

Director Sweet: That is, your petition for approval of the committee?

Mr. Pantaleoni: Recognition.

5240 Director Sweet: No, it is not necessary to serve that at the hearing. You should notify the parties to the proceeding of the application.

Mr. Pantaleoni: But we do not have to serve copies?

Mr. Burgess: Not here; no.

Is there any cross-examination of Mr. Walker or of other parties?

Mr. Marsh: I would like to cross-examine Mr. Oliphant very briefly.

Director Sweet: Is Mr. Oliphant here?

Mr. Gilpatric: Mr. Director, I wonder if Mr. Scandrett could be recalled first, on behalf of the Debtor. He has some general testimony to bring out for the record.

Director Sweet: If it is preferred, Mr. Scandrett will be called first.

H. A. SCANDRETT testified further as follows:

Direct Examination.

Q. (By Mr. Gilpatric.) I might say, Mr. Director, that Mr. Swaine being ill, I have undertaken to take his place in his absence.

Director Sweet: I might state also for the record that Examiner Jameson, who expected to be here, is ill,
5241 and that Commissioner Porter is detained for a short time, but will be in here a little later.

Q. (By Mr. Gilpatric.) Mr. Scandrett, have you a statement to make with regard to the 1937 operations of the St. Paul property?

A. Yes; I have.

At previous hearings in this proceeding I have put in the record a running account of the result of operations of the property beginning with 1928, and the record is complete in that respect up to the end of 1936, and I desire at this time to make a corresponding statement covering 1937.

At the September 20, 1937, hearing I summarized briefly the results of operations for the seven months ended July 31, 1937. I now desire to make a similar summary for the entire year 1937.

Railway operating revenues were $107,662,276, a decrease, compared with 1936, of $1,479,810, or 1.48 per cent.

Railway operating expenses were $87,137,444, an increase of $1,893,090, or 2.2 per cent.

Operating expenses classified were:

Maintenance of Way and Structures	$17,370,183
Maintenance of Equipment	20,627,129
Traffic	2,708,358
5242 Transportation	14,985,006
Miscellaneous Operations	929,316
General	3,886,777
Transportation for Investment, Credit	369,325

Net railway operating income for the year was $8,790,661, a decrease, compared with 1936, of $670,697. The figures for the year 1937 include a credit of $1,523,755 reversing charges included in the year 1936 on account of the 1936 Railroad Retirement Act, later amended to become effec-

tive January 1, 1937; eliminating the credit from the 1937 results, net railway operating income for 1937 was $2,194,452 less than 1936.

Income available for fixed charges was $9,824,734; fixed charges were $14,902,320, which left a deficit of $5,077,586 before deduction for interest on convertible adjustment bonds. Interest on these bonds accrued at 5 per cent was $9,143,685, making a deficit of $14,221,271 for the year.

The net increase in investment in road and equipment during the year was $10,334,835. This increase was due to gross additions and betterments to road property of $5,408,180 and of equipment of $9,700,802, a total of $15,108,982, less retirements and conversions of $4,774,147.

Funded debt in the hands of the public increased
5243 $4,507,136. By way of parentheses, you will note that that is about $6,000,000 less than the increase in investment.

It was increased $7,755,000 by the issuance of equipment trust certificates, Series "P", "Q" and "R", and reduced by the payment of equipment obligations of $2,957,864 and by the payment of one serial collateral note (former PWA loan) to Reconstruction Finance Corporation, principal amount $290,000.

Equipment trust certificates, Series "P", principal amount $3,180,000, were sold at 102.55-plus per cent of par. They bear interest at the rate of 3½ per cent and mature serially, beginning January 1, 1938, in fifteen annual installments of $212,000 each. This trust covers the purchase of one Hiawatha type locomotive and thirty new freight locomotives.

Of those thirty new freight locomotives, twenty-eight of them are now in service on the railroad.

Equipment trust certificates, Series "Q", principal amount $2,555,000, were sold at 100.067-plus per cent of par. These certificates bear interest at the rate of 3¼ per cent and mature serially, beginning March 1, 1938, in fifteen annual installments of $177,000 each. The proceeds from the sale of these certificates were applied to the
5244 construction, in the shops at Milwaukee, of 33 passenger train cars, 500 hopper coal cars, and 500 automobile cars.

Equipment trust certificates, Series "R", principal amount $1,920,000, were sold at 102.44-plus per cent of par. These certificates bear interest at the rate of 3¼ per cent and mature serially, beginning August 1, 1938, in

fifteen annual installments of $128,000 each. The proceeds from the sale of these certificates are being applied to the cost of constructing in the shops at Milwaukee, one thousand 70-ton gondola cars.

During the year the Railroad Credit Corporation credited on our note of June 27, 1934, $166,171, the company's share of distributions under the marshalling and distributing plan, which, together with a payment of $30,000 made by the Milwaukee Land Company, reduced the balance due on this note, as of December 31, 1937, to $366,374. On the note dated May 29, 1933, payments were made during the year by the Milwaukee Land Company in the amount of $920,000, completing the payment thereof.

The balance of advances by the company to the Railroad Credit Corporation, subject to distribution in accordance with the marshalling and distributing plan, as of December 31, 1937, was $498,513.

Expenditures for additions and improvements to
5245 road property and equipment were made under approximately 1,940 AFEs. The larger projects with the amount charged to investment account are:

For the operation of thirty new freight locomotives it was necessary to strengthen a number of bridges between Chicago and Council Bluffs and Chicago and Minneapolis, to install new 110-foot turntables replacing 90-foot turntables at six locations, and to enlarge enginehouses at seven locations. All of this work was not completed but $576,082 was expended during the year.

Air conditioning was installed in 47 cars at a cost of $432,110.

202 units of equipment no longer fit for revenue service were converted to work equipment and equipped for use of roadway gangs, at a cost of $50,304.

Additional facilities for charging batteries in air-conditioned cars during their lay-over were installed at our coachyards at Chicago, Milwaukee, Minneapolis and Tacoma, at a cost of $102,046.

A mountain type passenger locomotive for use on our Olympian trains between Avery, Idaho, and Othello, Washington, was constructed at our Milwaukee shops at an estimated cost of $125,000, of which $71,370 was expended
during the year. This locomotive was completed and
5246 placed in service in the latter part of February, 1938.

Boosters were applied to seven Class L-3 freight locomotives for service on Terre Haute Division coal

trains, at a cost of $68,101. It is estimated this will result in an annual saving of $21,676, after allowing for depreciation on the cost of the boosters.

Snow fighting equipment consisting of ten flangers, five cut wideners and twenty-three car plows were constructed by using old freight equipment no longer fit for revenue service, at a cost of $55,721.

Feed water heaters were applied to thirteen Class L-3 freight locomotives at a cost of $41,338. It is estimated this installation will result in an annual saving of $1,438 per locomotive, or a total of $18,694.

200 gondola cars were converted to flat cars and equipped with steel bunks for logging service at a cost of $40,664.

Power reverse gears were applied to fifty locomotives at a cost of $41,021. This application is required by an order of the Interstate Commerce Commission.

We have a specified time to do that work. That is only
the work that was done in 1937. There will be addi-
5247 tional costs in later years.

Passing tracks at five locations between Chicago and Milwaukee were extended at a cost of $42,163.

A traffic control system was installed in the heavy density territory between Sturtevant and Lake, Wisconsin, at a cost of $18,904. It is estimated that this will result in an annual saving of $4,200.

Automatic block signals were installed in the congested territory between Grand Avenue, Milwaukee, and North Milwaukee, at a cost of $17,797. This is a safety measure but will also result in a saving of approximately 8 per cent per annum on its cost.

Expenditures for new bridges, trestles and culverts amounted to $827,171. In addition to a large number of bridges and other water openings which were replaced with similar structures, 9,811 lineal feet of open deck untreated timber bridges were replaced as follows:

With steel structures, 820 lineal feet;

With creosoted timber and ballasted deck trestles, 2,624 lineal feet;

With culvert pipe, 2,163 lineal feet;

With embankments, 4,204 lineal feet.

23,822 gross tons of new rail ranging in weight from
90-pound to 131-pound per yard, and 27,851 gross
5248 tons of second hand rail ranging in weight from 50-
pound to 131-pound per yard was used in replacing rail of the same or lighter weight. The total charge to

investment for this rail, together with angle bars, tie plates, rail anchors, switch material, etc., (including the charge-out price for second-hand material) was $1,015,378.

Additional ballast chargeable to investment account was applied at a cost of $168,693. The greater part of this ballast was applied at points where main track rail was relaid.

A chain link fence 72 inches high was constructed on both sides of the right of way between Armitage and Diversey Avenues, Chicago, at a cost of $12,022. This was necessary to prevent the injury or death of small children who had been using the right of way as a playground. I mention that not as an important expenditure, but as typical of some of the things that we have to do to protect people from injury. That is only a part of a very considerable amount of work that we have done in past years along this line.

Part of the enginehouse and machine shop at Dubuque, Iowa, no longer used in transportation service, were improved for a lease to a manufacturing company, at a cost of $22,730. It is estimated the tenant will give us
5249 additional freight revenue of $60,000 a year.

The sheep yards at Kirkland, Illinois, were destroyed by a windstorm and replaced at a cost of $29,820.

Two warehouses at Butte, Montana, estimated to cost $31,443, on which work was started in 1936, were completed during the year. The expenditure in 1937 was $17,691. These warehouses are leased and it is estimated the railroad company will receive additional revenue of $63,000.

A ski bowl and facilities for serving patrons was constructed at Hyak, Washington, on the east slope of the Cascade Mountains, at a cost of $22,571. There is much interest in skiing in that part of the country and a nice passenger business has developed from this investment.

The mechanical department facilities at Marquette and Ottumwa, Iowa, and Austin, Minnesota, were equipped for electrical operation at a cost of $60,730. This will permit the steam power plant to be closed during the summer months and operation at low pressure during the winter months for heating purposes only. It is estimated it will result in an annual saving of $16,380, or 37 per cent of the cost.

We have done that same thing at a very great
5250 number of points on our line with most substantial savings in every case.

New shop machines and tools were purchased and installed at a cost of $400,042.

Improvements to the electrification facilities on the lines west of Mobridge were made at a cost of $68,845. These improvements are to safeguard the lives of employees or to eliminate fire hazards.

Assessments for public improvements amounted to $21,862.

Q. Mr. Scandrett, have you made any estimate of the effect on the St. Paul revenues of the recent rate increases authorized by the Commission?

A. Well, our accounting department has made such an estimate, Mr. Gilpatric, and the figures I give are based on 1937 revenues, although, as I will point out later, and as everybody knows, 1938 revenues are very substantially lower than in 1937.

The Commission authorized increases of 5 and 10 per cent on different traffic, but provided in its order that increases allowed in 1937, in what is known as Ex Parte 115, should go to reduce the amount allowed in Ex Parte 123, and our calculations, of course, take that into consideration.

5251 On the basis of 1937 revenues these increases in full, by which I mean without any deduction for the increases theretofore allowed, would amount to $6,593,198. Now, those deductions that were required for the reason I have stated amount to $1,264,458, making the net increase on the basis of the 1937 revenues $5,328,740.

Now, from this must be a further deduction representing a 10 per cent increase in the switching charges which we absorb. That amounts to $298,119. As reduced by that, the net increase in freight revenue under Ex Parte 123 is $5,030,621, which, stated in percentage of total freight revenues for that year, is an increase of 5.47 per cent.

The switching charges, demurrage charges, storage yard and other accessorial charges were also increased or increases were also authorized by the Commission, which we estimate will bring to us $300,000. Adding that to the previous figure, the net increase in all revenues is $5,330,621.

Now, this assumes that all of the increases authorized by the Interstate Commerce Commission are made effective on both state and interstate business.

Q. Does that take any account of possible losses of traffic due to higher rates?

A. No, sir.

Director Sweet: Did you assume the same busi-
5252 ness that moved in 1937?

The Witness: Applied to the 1937 business.

Q. (By Mr. Gilpatric.) Mr. Scandrett, are you in a position to make any kind of a forecast for this coming year, or any part of it, in regard to the operation of the railroad?

A. Well, I do not think I am in a position to do that. We have made a stab at it.

Q. You might give us what you have, then, with that reservation.

A. It is more than usually difficult to make a forecast of earnings at this time, and any estimate we make may well prove wide of the mark.

Our freight revenues in January of this year were 11.4 per cent and in February 16.2 per cent less than in the corresponding months of 1937, and it looks as if the reduction in March would be about 20 per cent.

We have assumed that for the months of April, May and June the reduction will be the same as in March, except as modified by the increased rates authorized by the Commission in Ex Parte 123.

We have assumed the increased interstate rates will be made effective by April 1st. The carriers are working to
March 28th, and I think they are quite hopeful that
5253 the great bulk of the increases will be made effective on that date, and that corresponding increases on intrastate rates will be made effective by May 1st.

Our passenger revenues in January were 6 per cent higher and in February 1½ per cent higher than in the corresponding months of 1937. We have assumed that the months of March, April, May and June the passenger revenues will be 2 per cent higher than in 1937. On this basis our freight revenues for the first half of 1938 would be $35,928,000 as compared with $42,725,000 in the first half of 1937, or a reduction of 15.9 per cent.

Passenger revenues on the basis indicated would be $3,809,000 as compared with $3,723,000, an increase of 2.6 per cent.

The total operating revenue would be $44,431,000 as compared with $51,680,000 in 1937, a reduction of 14 per cent.

We have curtailed very substantially our maintenance expenses, both way and structures and equipment, and propose to continue this program during the next four months.

Work postponed which normally would be done in the first half of the year will be given further consideration when we can see better what is before us in the later months.

Our estimated expense for transportation is what
5254 we hope and expect can be accomplished, and takes into consideration both the reduced volume of traffic and the increase in wages and materials.

Social Security Unemployment Taxes in percentage of payroll are higher than in 1937 because the rate was increased from 2 to 3 per cent on January 1, 1938.

Net income available for fixed charges is estimated to be a deficit of $30,000 as compared to some $3,500,000 income last year after eliminating a credit of $1,524,000 reversing charges made against income in 1936 for Railroad Retirement Act taxes made inoperative for that year by amendment of the Act.

We estimate that after making interest payments as provided in the 1935 plan, excluding however any interest on the general mortgage and any contingent interest under that plan, and after making those principal payments of equipment trust as provided in the 1935 plan and initial payments on new equipment, our cash on hand June 30th will be about $4,000,000 less than it was on January 1st and our available cash on hand at the end of June will be about $3,400,000. In order to attain this figure we are in the first six months curtailing substantially our maintenance and improvement program, as I have indicated.

Q. Have you an exhibit, Mr. Scandrett, to support that?

5255 A. Yes, I have, Mr. Gilpatric.

I should like to have the record show that insofar as this may be designated as a forecast of revenues, I do not think it is anything more than the most intelligent guess that we are capable of making, and I shall not be tremendously surprised if it is rather wide of the mark.

Director Sweet: Exhibit No. 204.

(The document above referred to was marked "EXHIBIT NO. 204, Witness Scandrett," and was received in evidence.)

The Witness: Our efforts, of course, will be, regardless of what the volume of the revenues is, to so control our expenses that we will have substantially the cash I mentioned on June 30th, which is very close to the minimum amount which we think is sufficient for us to get by with.

Q. (By Mr. Gilpatric.) Mr. Scandrett, will you make any comment as to the physical condition of the road at the present time?

A. Well, I went into that subject at considerable length, Mr. Gilpatric, in 1935. I don't know whether I did in 1937 or not, but I feel, based on what I know about it, and based on the informed judgment of our operating officers, that the physical condition of our plant, both roadway, structures and equipment, is excellent.

5256 There are a few things we could improve the appearance somewhat on, for instance, with a greater use of paint, thereby making more attractive the property. But as I say, our physical condition is excellent and as good as it was at the beginning of the depression in 1930.

Q. Is there anything to be said at this time in addition to what is already in the record as to coordination and pooling projects?

A. Well, we are studying coordination projects constantly. Coordination and consolidation are very much discussed at the present time as ways and means of improving the very desperate condition of the railroad industry. I think if I were to hazard a guess, that I would say that consolidation is on the way. I do not think it will arrive soon enough to take care of the present crisis, but as a remedial measure for the future I think that we very likely will have rather extensive consolidation of railroad properties.

Q. You did during the year begin operations under an iron ore traffic pool, did you not, with the Chicago & North Western?

A. Yes. Our traffic pool was in effect during 1937.

The order of the Commission approving that pool was attacked in court and the case went all the way

5257 through to the Supreme Court of the United States and the Commission's order was affirmed by the Supreme Court about a month ago.

Q. Do you anticipate any benefits, from the standpoint of the railroads, as a result of the regulation of truck competition?

A. Well, I think that condition has somewhat improved over what it was prior to the passage of the Motor Carrier Act, and I think that when the Commission gets on top of that job, which has been a tremendous job, and they have been short-handed, as I understand it, that you will

have a very much more stabilized situation, and when you have a stabilized situation, why, you are better able to meet it.

I also think that there are a very large number of motor carriers masquerading as contract carriers that it will be ultimately found and held are common carriers.

Now, I suppose the reasons for those questions, Mr. Gilpatric, is to develop whether I think in the near or the far future there are possibilities for substantially improved earnings of this railroad and other railroads.

I think that is so. I do not believe that the railroad industry is through and I do not believe it is through under private operation and management.

5258 I do not see any reason why we should calculate for the future that we are going to be forever in a slough of despond.

Now, that brings up the question to my mind of the rights of stockholders in this and in other properties. It seems to me if you forego absolutely the equity of the present stockholders, it is more or less equivalent to resolving adversely all developments for the future.

Take the Milwaukee road—I have not had a chance to look into it recently—but for fifty years, I would say, the Milwaukee road paid dividends on its common stock and on its preferred stock. It had one of the best dividend records of any railroad in the country. The aggregate number of dividends paid during that period was very large.

The Milwaukee road weathered the storm of the great depression in the 1890's, when a great many other roads were forced into receivership; not only weathered the depression, but it paid dividends throughout the period.

As I recall it, during the period of federal operation during the war, the standard return of the Milwaukee which was based on its earnings of the three previous years ending with December 31, 1917, was about $28,000,000.

5259 When the new company took over in 1928, in that year and in 1929, the earnings were about $29,000,000 which covered all fixed charges and full dividends on the preferred stock and something for the common.

I just do not think it is right to put through a plan at this time when things do not look very good to anybody, and shut the door forever on these stockholders. I think they ought to have a run for their money.

Mr. Gilpatric: I think that concludes, Mr. Director, what the Debtor has to offer at this time.

Our position has not changed since the last hearing, but I do not want to repeat what was said then.

Since that hearing in February, with the cooperation of counsel for the Institutional Committee, counsel for the Debtor have attempted to arrive at a common ground in regard to the capital structure to be provided for and the extensions to be provided for under the Investors' Plan.

Those efforts to date have not been successful, and we have nothing further to offer or say at this time in regard to the institutional investors' plan.

We feel there are certain points in the record which perhaps have not been fully covered, such as the allocation
of the earnings to the lines west. Perhaps what is
5260 going to be offered at this hearing will fill that gap,
but we still feel that at the present time, until clarification of existing conditions, that the reorganization is not feasible.

Director Sweet: Is it the position of the Debtor that it desires to withdraw the plan that it has already presented?

Mr. Gilpatric: No; we do not desire to withdraw it; although we recognize it is not feasible at the present time. We think if some of these circumstances which Mr. Scandrett has mentioned are resolved favorably, that that plan might be the basis of reorganization.

There are, of course, two factors in it which will have to be remedied, that is, the provision for the accumulation of interest for ten years on the fifty-year 5's, and the provision for new financing.

We recognize those deficiencies will probably exist in the revival of that plan, but we would like to leave the plan on record.

Director Sweet: Any cross examination of Mr. Scandrett?

Mr. Pantaleoni: May I ask a question or two?

Director Sweet: Yes.

Cross-Examination.

Q. (By Mr. Pantaleoni.) Mr. Scandrett, have you
5261 any information with regard to the possible legislation which would relieve somewhat the effect of competition of the Panama Canal route?

A. Well, of course, there is pending in Congress the so-called Pettengill bill amending the 4th Section of the

Act. That would not relieve the competition with the Panama Canal, but it would put the railroads in a position to compete with the Panama Canal.

Q. It would permit you to lower your rates?

A. Sir?

Q. It would permit you to lower your rates?

A. Well, just to lower them to the competitive point, and it would be very helpful to the Milwaukee Railroad.

Q. You feel that would be very helpful?

A. Very.

Q. That would also, I imagine, help the lines west of Mobridge perhaps more than the lines east?

A. Well, the tonnage that we would be able to get to the ports of Seattle and Tacoma, and which we do not get now, would most over the lines west as well as the lines east.

Q. How important do you think a change in the capitalization of this company is for the future of this company? Does it touch any of the basic difficulties with which the railroad is faced?

5262 A. Well, of course, with management, the lower your fixed charges are, the easier your position is, but I do not feel that this so-called putting the capitalization through the wringer is any cure for the ills that beset the railroads.

Q. Or that beset this particular railroad?

A. That is true.

Q. Mr. Scandrett, I understood from Mr. Swaine's remark made at the closing of the last hearing preceding this adjourned hearing, that it was the general opinion of Mr. Sparrow—I believe it was Mr. Sparrow, that there had not yet been made sufficient surveys which would reflect an accurate allocation of the revenues as between the lines west and the lines east. Do you subscribe to that opinion?

A. Well, I do not subscribe and I do not differ with it. I think that there was made under Mr. Sparrow's direction, and it was testified to by Mr. Sparrow, a study on a formula which was the basis that he and his associate officers devised, and that study, by the use of that formula, showed certain results.

Now, I do not know that it is for us to say whether that is adequate or inadequate. It is the best that we could do.

Q. Within the time at your disposal?

5263 A. Well, I do not think the question of time was very important there. I think we had lots of time; in

other words, we devised the best formula that we knew how, or that we could work out, and the study was made on that basis.

Now, whether that is adequate as between allocating earnings to different liens, as I say, I do not think it is for me to be the judge.

Q. Have you any figures on the total of defaults, on replacement of equipment under the various mortgages?

A. Well, we have that all in our records. I haven't that in mind.

Q. You haven't it available?

A. No.

Q. I suppose you have in your records somewhere available information with regard to the date when those respective defaults first occurred?

A. Well, I am talking about defaults since the new company took over in January 1928.

Q. That is right.

A. Are you talking about that?

Q. That is what I am talking about.

A. Well, I would prefer to have you ask one of our accounting officers that question, Mr. Pantaleoni. I think we have a full record of it.

5264 Mr. Gilpatric: I might interject that there were exhibits put in the record at the earlier hearings showing that.

Mr. Pantaleoni: Well, I was wondering whether we could have it brought up to date and whether we could have it specified as to when the defaults first occurred under the first and refunding mortgage, which is what I am interested in.

Mr. Gilpatric: We will talk that over with our people.

Mr. Pantaleoni: All right, thank you.

Director Sweet: Any other questions of Mr. Scandrett?

(No response.)

Director Sweet: You may be excused.

The Witness: Thank you, sir.

(Witness excused.)

Mr. Marsh: I have a few questions I would like to ask Mr. Oliphant.

Director Sweet: Please come forward, Mr. Oliphant.

C. E. OLIPHANT testified further as follows:

Cross-Examination.

Q. (By Mr. Marsh.) Mr. Oliphant, in the previous hearings there have been several exhibits introduced showing an allocation of earnings or expenses to the Milwaukee & Northern Lines. Those dealing with 1936 figures were Nos. 141, 142 and 156, that I have particular reference to.

5265

A. Yes, sir.

Q. Have you prepared some exhibits supplying the details showing how the item of rental on equipment, an item of $146,944, appearing on those three exhibits, was computed; also showing some additional information.

A. Yes, sir.

Q. Will you produce it?

A. What was the item you referred to?

Q. The item of $146,944 which appears in Exhibits 141, 142 and 156.

A. Yes. That is the equipment rent in 1936.

Q. Now, you have two exhibits, have you not, furnishing the details as to that computation?

A. Yes, sir. I have an exhibit here that is a copy of one of our working papers, in producing the exhibit.

Q. Then there is another exhibit of three pages, is there not?

A. The first exhibit we are talking about deals with the comparison of the equipment rent as included in the exhibit and as would be modified if credit was allowed the Milwaukee & Northern for the equipment once owned.

5266

Q. Yes.

A. And since retired.

The other exhibit, consisting of three pages, relates to locomotives, and the basis of locomotive rent and freight car and passenger car rents for the year 1936.

Q. Also work equipment?

A. Yes, sir.

Director Sweet: Let us get the record straight, now. As I understand it, Exhibit No. 205 is headed "Milwaukee & Northern Lines—Equipment Rents as Charged for System Equipment for Year Ending September 30, 1933," and so forth, and Exhibit 206 is a three-page statement headed

"Milwaukee & Northern Lines, Development in Interest Rental—Locomotives—Year 1936."

The Witness: Yes, sir.

Director Sweet: All right.

Mr. Marsh: We offer those in evidence.

(The documents above referred to were marked "EXHIBITS NOS. 205 and 206, Witness Oliphant," and were received in evidence.)

Q. (By Mr. Marsh.) If you will turn to page 3 of Exhibit 206, there is a footnote there describing how you have computed the costs on which the interest rental on passenger cars was arrived at, is there not?

5267 A. Yes, sir.

Q. Now, there is no footnote of that kind in the previous pages of Exhibit 206 referring to locomotives and system freight cars?

A. Well, there is a note of a similar tenor.

Q. Approximately that same method of figuring cost was used as to all of the equipment?

A. Yes, sir; reproduction cost new less depreciation.

Q. But that includes an allowance in the case of equipment constructed in your own shops of an additional one-third representing what you estimate would have been the cost of that same equipment if manufactured by outside builders?

A. Yes, sir; as if purchased.

Q. As if purchased?

A. Yes, sir.

Q. Now, have you computed what reduction would be made in the item of rental for system equipment, $146,944, appearing on these three previous exhibits, 141, 142 and 156, if you had used book value instead of this reproduction cost as the basis for computing the rental on this equipment?

A. We made a very approximate estimate one day in a hurry using the average system book value of equipment.

5268 It is not the book value of the equipment that was used on the Milwaukee & Northern.

Q. I see.

A. And our figures show that the equipment rents would have been reduced some $64,000 if the average system book value had been used in place of our reproduction cost less depreciation, 50 per cent.

Q. That is using the same rate of 5 per cent, is it not?

A. Yes, sir.

Q. Now, in accordance with Mr. Walker's testimony at the previous hearing, at the last hearing, he referred to certain additional charges that might possibly be made against the Milwaukee & Northern lines which were not included in the expenses charged against it in your computation, and as I remember it, one item was a possible charge for part of the overhead of the Milwaukee shops.

A. I believe Mr. Walker made some reference to that without giving an amount.

Q. Without giving an amount?

A. Yes, sir.

Q. Now, have you made a computation showing roughly what that charge would be?

A. Yes. We have made a little study of our overhead shop at Milwaukee, our overhead expenses at Mil-
5269 waukee shops, however, and for the year 1936, had that been charged to the Milwaukee & Northern, it would have increased the Milwaukee & Northern expense about $18,000.

Q. That was based on a rather detailed study of the Milwaukee & Northern shop work, was it not?

A. Yes, sir; as to the amount done at the Milwaukee shops.

Q. As to the amount done?

A. Yes, sir.

Q. And the overhead was computed on the basis of the total output of the Milwaukee shops as compared to the total overhead of the Milwaukee shops?

A. Yes, sir. We used the maintenance expense, interest on investment, depreciation, insurance and taxes.

Q. And maintenance?

A. And maintenance of the shops, and divided that by the total output, including new equipment constructed.

Q. Now, you had made a rough computation of that figure before the last hearing, had you not? That is, an estimate rather than a computation?

A. We made a very rough estimate in a very short time one day using the system overhead instead of the Milwaukee shops overhead and had a figure in mind of something like $49,000.

Q. But your figure of $18,000 is much more accu-
5270 rate, is it not?

A. Yes, sir, and that relates particularly to the Milwaukee shops overhead.

Q. Now, I am not certain whether this item was re-

ferred to in Mr. Walker's testimony or not, but there was a suggestion made that an additional charge might be made against the Milwaukee & Northern on account of the proportionate share of maintenance of the Milwaukee passenger station and tracks used by the Milwaukee & Northern, between the Milwaukee Station and North Milwaukee.

A. I do not know whether Mr. Walker touched upon that item, but it has been considered that instead of separating our revenues at North Milwaukee, that the revenues from Milwaukee station proper should be allowed to the Milwaukee & Northern and that the Milwaukee & Northern should be charged a rental for the Milwaukee passenger terminals.

Q. Well, if that were done, the net effect would not be large, would it?

A. The effect would be to add to the expenses of the Milwaukee & Northern about $4,000.

Q. That is for 1936?

A. For 1936; yes, sir.

Mr. Marsh: Thank you. That is all.

5271 Director Sweet: Any other questions from Mr. Oliphant? Any redirect? He is here on cross examination. You are excused.

(Witness excused.)

Mr. Marsh: Now, we have a witness on direct, if you have reached that point.

Mr. Burgess: Might I ask if the Debtor has concluded?

Mr. Gilpatric: Yes, the Debtor has concluded.

Director Sweet: Well, if there are those who wish to cross examine Mr. Walker or other witnesses who have testified heretofore, perhaps that might be better, Mr. Marsh, than to take up your direct at this time. Anyone wish to cross examine Mr. Walker or any of the other witnesses?

Mr. Freund: I would like to ask Mr. Walker some questions.

F. W. WALKER testified further as follows:

Cross-Examination

Q. (By Mr. Freund.) Mr. Walker, in the plan of the institutional group there is provision that the holders of the 4½ per cent Series B general mortgage convertible income bonds shall have the privilege, unlimited as to time, to convert their bonds into common stock at
5272 the rate of fifteen shares of such stock for each $1000 principal amount?

A. That is correct.

Q. Is there any mathematical basis on which your committee or your group has arrived at the basis of that conversion?

A. No; there is no practical basis.

Q. Well, is there any reason why it should be 15 rather than 10?

A. Yes; I think so.

Q. Well, what is that reason?

A. I think the reason is that even assuming that the common stock, the no-par common stock had approached a value of $100 a share, there would be no conversion from the convertible bonds into the common stock unless there was a prospect of receiving more in the way of income after conversion than if there were no conversion.

The general mortgage income bonds, Series B, have a 5 per cent coupon. They also are secured by a lien on the property of the reorganized company, second as to principal, second in lien to the first mortgage, of the new first mortgage, and therefore to induce conversion it would of course be necessary to give more in par value—not
5273 par value, but more in probable realization of principal, where a mortgage lien were surrendered than a junior position with respect to income were surrendered, and therefore it was felt that fifteen shares might at some time in the future induce conversion which might improve the entire capital structure.

Q. That was only your committee's notion as to the fairness or probability, rather than any basis; it is merely your opinion?

A. That is all.

Q. Now, the adjustment bondholders under your plan, of course, lose their mortgage position, too; in fact, they are put down in the common stock?

A. That is correct.

Q. Now, this conversion of this Series B general mortgage bonds will dilute the equity which is given to the adjustment bondholders as those bonds are converted?

A. In one way it will dilute it, while in the other way it will reduce the prior claim on income before dividends on common stock.

Q. Well, those are two different things. It will dilute, unduly dilute it, I mean?

A. Only as the number of shares, the relative number of shares would dilute it, but when speaking of dilution, I take it it means dilution of value, and so this other
5274 element must be taken into consideration.

Q. But if all of those bonds were converted, what effect would that have on the percentage the adjustment bondholders would have?

A. Well, that would be a matter of calculation.

Q. Well, would you say it would reduce it about from 90 to 70 or 71 per cent; thereabouts?

A. What is the question?

Q. If the Series B bonds were converted on the basis of 15 shares for each $1000 bond, what would be the percentage of the reduction and what would be the percentage left to the adjustment bondholders in the equity?

A. Well, the adjustment bondholders receive 2,578,519 shares of no par common stock which, taken at $100 a share, would be $257,000,000.

Under the plan there would be outstanding $49,828,000 par value 5 per cent Series B general mortgage bonds, which I have taken as approximately $50,000,000,—$49,000,000 there would be outstanding; I may have misspoken on account of the three ciphers being omitted in this exhibit.

There would be $49,828,000 Series B 5 per cent bonds outstanding which I have taken at approximately $50,000,000 of bonds, and exchanging for every $1000 of bonds
15 shares of common stock, assuming the same
5275 value for that no par common stock of $100.

The adjustment mortgage bondholders would receive $75,000,000 of no par common stock—not the adjustment mortgage bondholders, but the previous holders of Series B general mortgage income bonds would receive $75,000,000 or 750,000 shares of no-par common stock and the adjustment mortgage bondholders would have $257,-

000,000 of no par common stock represented by 2,570,000 shares, approximately.

That would be the situation.

Q. Well, they would reduce from about 90 per cent that they now have to around 70, wouldn't they, of the total outstanding?

Director Sweet: That is only a matter of computation, isn't it?

The Witness: That is a matter of computation.

Director Sweet: You can argue it in your brief.

Q. (By Mr. Freund.) Well, now, is there any reason why that should be 15 rather than 12, except the opinion of your committee?

A. Well, that is the reason, the opinion of our committee, that that would be necessary to induce the conversion.

Q. Now, the plan provides that the new 5 per cent preferred stock should be entitled to participate equally
5276 with each share of common stock to the extent of one dollar in addition after payment of $3.50 per share on the common.

A. That is correct.

Q. Is there any mathematical basis for fixing that?

A. Not a mathematical basis, but I believe a very good reason for fixing it in that way.

Q. What is the good reason?

A. The reason is this, that the preferred stock's noncumulation and a limitation with respect to dividends on common is that no dividends shall be paid on the common until after dividends have been paid, full dividends have been paid on the preferred three consecutive years.

Therefore there is nothing in the way of accumulated dividends that have piled up ahead of the common stock, notwithstanding the fact that the preferred stock is accepted in part satisfaction of the claims of creditors prior in lien, their claim being prior in lien to the claim of the adjustment bondholders, and for the further reason that when the common stock which is received by the adjustment bondholders receives a dividend of $3.50 per share, the adjustment bondholders will then have received in
dividends the full amount of interest, annual interest,
5277 which they previously enjoyed upon the principal of their adjustment bonds, and therefore in partial satisfaction of the sacrifices of the preferred stockholders,

for the surrender of the non-accumulations of dividends, they should participate with the common stock.

Now, the basis for limiting it to one dollar per share participation was that unless limited, it would prevent to a much greater extent, at least, conversion of the general mortgage bonds than would be the case if there was a limitation, and that this one dollar per share additional, which would come to the preferred stock would not, as a matter of fact, fully compensate them for their sacrifices.

But, it was in the nature of a compromise in order that the value of the common stock should not be held down to the extent it would be held down if the participation was not limited.

Q. You just said that the adjustment bonds, having this common stock, if they get $3.50 per share on the stock, would then get all of the interest that they had previously on their investment.

A. Yes.

Q. Why shouldn't they get some compensation for being put out of a lien position and having to wait at the end of the line for so long?

5278 A. They do get compensation to the extent that as the preferred stock would participate with the common, so would the adjustment bondholders, having received their full previous income, would then be receiving income upon the accumulated interest and the stock which is given to the adjustment bondholders represents accumulated unpaid interest prior to bankruptcy or prior to the filing of the petition in June 1935, and also accumulated and unpaid interest to the effective date of the plan.

They have been taken care of, and at any event their sacrifice is junior in right to the sacrifices made by the seniors, the holders of the senior securities.

Q. Is it your theory that every security would be satisfied in full before the next junior security is taken care of?

A. It is my theory that at law they are entitled to that satisfaction as a matter of right, and that any variation from that is a variation from what they are really and properly entitled to have. That is my theory.

Q. Then, do you feel that there is no difference between a reorganization in 77 and a reorganization by foreclosure?

A. Not as to the rights as to secured creditors;
5279 the relative rights of secured creditors and the relative rights of secured creditors and stockholders.

Q. And you formulated your plan on the same principle?

A. That is exactly right.

Q. Now, you have provided in your plan for—

A. We formulated it on that plan and any variations that are in there are things that have been put in,—and a number of things have come in—in the hope of securing favorable vote by the various classes of creditors affected by the plan, and the stockholders.

Q. You have in your plan an additions and betterments fund of $2,500,000 which is mandatory?

A. Yes, sir.

Q. Why shouldn't that be left discretionary with the directors?

A. Because of the fact that in addition to the probable necessity for its use annually for additions and betterments, there should be built up, as we feel and believe, a reserve and retirement fund against the present contingencies or obligations that are shown in the plan, and in addition to that, to the extent that there is $2,500,000 available after the payment of fixed interest, that amount of money should be plowed back into the property and should not be capitalized, and we believe it is essential that there be plowed back into the property substan-
5280 tial amounts out of earnings, and should not be capitalized.

Q. Why shouldn't that be left to the discretion of the directors?

A. I believe that it is a very much sounder policy to require actual segregation of the funds for depreciation and to require—as you look at the railroad picture and at these different railroads, and what has been the universal practice up to the present time with respect to the issuing of bonds for 100 per cent improvements and betterments as against the restrictions we have in this plan—I believe it is in the interest of the public and I believe it is in the interest of the investors, whether their investment be in bonds, or whether it be down in the common stock that it is proposed to give to the investment bonds, that at least $2,500,000 should be plowed back into the property annually, if it is available, after meeting fixed charges.

Q. I would like to ask you one more question about the voting trust about which I asked you at the last hearing.

A. Yes.

Q. Voting power adds very considerably to the marketability of the value of a stock, doesn't it?

A. Yes, sir, I would say voting power adds to the marketability and market price.

5281 Q. And is there any good reason why the adjustment bondholders who are deprived of their lien and left solely to what comes from the equity, should not have control of that property?

A. In what way?

Q. By having the free right to vote.

A. Having the stock free?

Q. Yes.

A. And eliminating the voting trust?

Q. Yes, sir.

A. As I testified before, I think that would be very unwise. I do not think it would be satisfactory at all, and I think that if that were the case that the control of that property could be obtained by probably a very small investment. The stock on reorganization would have but little market value. The price would not be commensurate with its future possibilities, and so the control could go for a very small amount, and the bondholders through the voting trust, the present bondholders through the voting trust could have control during the period of the voting trust, representing investors of the type that invests to hold to maturity, generally, but of the type that do not invest for the purpose of realizing some profit through resale or arbitrage, going in and out, and when this

5282 road comes out of reorganization, if the stock is thrown on the market free, why it simply would be a matter of control possibly falling into the hands of people who were not interested in a permanent investment in that property, and the property under the existing conditions has a situation ahead of it, as with all other railroads, that in my opinion makes it very desirable that the control after reorganization, for a limited period of time, as provided in the voting trust, should be with that type of investors who are going to stay with the property.

Q. Well, judging by the history of the past, do you think there is any more assurance of good management from them than from anyone who would take enough new money and go in and buy control of that road, and assuming that it could be bought?

A. Well, as I stated, I do not think that the control or the purchase of the control would require much money, because you do not need a very large block of stock, as has been shown, to permit of obtaining a control through proxies for the remainder.

The price of the stock, as I believe, after the reorganization, will be so low that virtual control can be obtained if people set about to do it, for a very small amount of money.

5283 Q. Wouldn't they raise the price and thereby stop control?

A. I don't think that they would have trouble to get enough, if they handled it in a knowing manner, to raise the price of the stock to a point that would result in the cost of the control being very high; that is my own view.

Mr. Freund: That is all.

Mr. Orschel: Mr. Walker, do I understand your interpretation of Section 77 to be an act, therefore—on the basis of which you testified—to be an act for the relief of corporate creditors rather than corporate debtors, is that correct?

Mr. Burgess: Isn't that a question of law that we had better argue?

Mr. Orschel: Well, he expressed his opinion of law.

Mr. Burgess: I am addressing my remarks to the presiding Commissioner.

Director Sweet: Well, it is a question of law. Of course, it is desirable to get any light we can as to the basis upon which this committee plan has been devised.

Mr. Burgess: Mr. Walker can answer the question if it is any assistance to the Director.

5284 Director Sweet: It may be.

The Witness: What is the question, please?

Q. (By Mr. Orschel.) I wanted to know whether or not your interpretation of Section 77 didn't make it an act for the aid of corporate creditors rather than for the aid of corporate debtors.

A. My interpretation is that it is an act for the reorganization of railroads under which the rights of corporate creditors, their lawful rights, will be preserved, as well as the lawful rights of the owners of the equity.

Director Sweet: As I understand it, that is the theory that you have gone on in working out this plan that you have presented?

Director Sweet: Any other questions?

Mr. Burgess: I have one or two.

Redirect Examination.

Q. (By Mr. Burgess.) In connection with that last question insofar as there are departures from the prior-

ities, an effort has been made to compensate in some manner for the sacrifices of every group, has there not, in the plan?

A. That is true.

Q. Now, referring to the question asked by Mr. Freund as to whether it would not be preferable to have dis-
5285 cretionary power in the board of directors as to the amount of the A and B fund, which under the plan is limited to $2,500,000 prior to the payment of contingent interest, is not that, in fact, a protection to those who will receive the contingent interest securities, to have a limitation on that in the amount of $2,500,000 or some other amount, other than to leave it wholly discretionary with the Board?

A. Yes. The limitation of it is a protection, and I believe the feature that it is obligatory is also a protection to all, to the entire property as to all of the security holders over the long period of time under which this railroad must continue to operate; that before contingent interest is paid there must be plowed back into the property $2,500,000 if it is earned annually.

And, the plan provides that after contingent interest is paid and after the sinking fund on the income bonds is provided for, then everything that remains thereafter, if use is discretionary with the Board, without penalty being attached, because the dividends or the preferred stock are not cumulative and there is no obligation on the part of the Board to use the funds remaining after the payment of interest on income bonds, and the sinking fund on income bonds for dividends. It is without penalty so that there is nothing there to force them to pay either
5286 dividends or subject the property to a penalty by reason of accumulation of preferred stock.

Mr. Burgess: That is all.

Director Sweet: Any further cross-examination of any of the other witnesses who have testified heretofore in this proceeding?

Mr. Orschel: I would like to recall one of the witnesses, Your Honor, please, for further direct examination.

Director Sweet: One of your own witnesses?

Mr. Orschel: Yes, sir.

Director Sweet: If there is no further cross-examination, you may do that.

UNITED STATES CIRCUIT COURT OF APPEALS

For the Seventh Circuit.

I, Kenneth J. Carrick, Clerk of the United States Circuit Court of Appeals for the Seventh Circuit, do hereby certify that the foregoing printed pages contain a true copy of volume II of the printed record, which together with volumes I, III, IV and V constitutes the printed record, printed under my supervision and filed on the sixth day of June, 1941, in the following entitled causes:

Cause Nos. 7590, 7610 through 7617.

In the Matter of Chicago, Milwaukee, St. Paul & Pacific Railroad Company, Debtor,

as the same remains upon the files and records of the United States Circuit Court of Appeals for the Seventh Circuit.

In Testimony Whereof I hereunto subscribe my name and affix the seal of said United States Circuit Court of Appeals for the Seventh Circuit, at the City of Chicago, this 15th day of January, A. D. 1942.

Kenneth J. Carrick,
(Seal) *Clerk of the United States Circuit Court of Appeals for the Seventh Circuit.*